So, you want to learn Bookkeeping!

by Bean Counter's Dave Marshall

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Bean Counter							

Hello my name is Dave and yes I'm a bean counter. No I didn't say alcoholic, that's a soft drink not a beer in my hand, and this is not a meeting of Alcoholics Anonymous. For those of you that don't know a bean counter is slang sometimes used to refer to a bookkeeper. I've searched the web for good free bookkeeping and accounting tutorials and came to the conclusion that they're hard to find so this is my attempt to try and fill the void. What qualifies me to attempt this task ? I guess you can tell it's not my fancy dress code. I have over 30 years experience in business and even taught at a small business college for a couple of years. My method of passing on knowledge is to make the subject easy to understand and to use simple examples and terminology to illustrate the concepts being presented. If you're anything like me I learn a lot easier when I can see an example of what we're talking about. Tell me and show me too.

This free bookkeeping tutorial is geared to business owners, managers, and individuals who have not had any formal bookkeeping training or on the job experience and need or want to learn the basics of bookkeeping. In other words, this tutorial is for beginners (newbies) or those needing a quick refresher and is only an introduction into the world of accounting. They say a little knowledge is a dangerous thing. Well my goal is to make you dangerous.

Tutorial Navigation

A menu of all the lessons is presented at the top and bottom of all the lessons. A back and next arrow also allow you to go back to the prior lesson or on to the next lesson. In addition, some Lessons contain Interactive Tables, Forms, and Lists. These sections include Navigation Instructions. The Lessons also include Links to additional learning materials and quizzes.

Additional Needs

- My bookkeeping and accounting quizzes and games require Adobe's Free Macromedia Flash Player which is

normally already installed on your computer.
Get Adobe's Free Flash Player.
• My Skill Tests require Javascript to be enabled in your browser. Most computers also already have this feature enabled.

What's Covered ?

This **Introduction** discusses the types of business organizations, types of business activities, users of financial information, bookkeeping systems, accounting rules, and the cash and accrual basis of accounting.

Lesson 1 The Bookkeeping Language introduces you to some of the terminology and definitions used in the accounting and bookkeeping language.

Lesson 2 Property and Property Rights explains Property & Property Rights, the Accounting Equation, double entry bookkeeping, and how business transactions affect the equation.

Lesson 3 Debits and Credits introduces and explains Debits and Credits and how they affect the Accounting Equation and are used to record business transactions.

Lesson 4 Recording Business Transactions explains and uses examples to illustrate how business transactions are properly analyzed, recorded, and summarized.

Lesson 5 The General Ledger and Journals explains what General Ledger and Journals are, how they're used, and what bookkeeping purposes they serve.

Lesson 6 Financial Statements explains what financial statements are, how they're created, and how they're used.

Lesson 7 Review of Major Concepts reviews the major definitions, concepts, and bookkeeping records previously discussed and necessary for an understanding of bookkeeping.

Introduction

Why Learn Bookkeeping ?
Why would you want to learn bookkeeping and keep up to date financial records anyway ? Can't you hire an accountant to come after the end of the year and get your check book and shoe box and do your taxes ? Sure you can ! And yes you will have adequately fulfilled your taxpayer obligations. But in order to run a business and know what, where, and when to take corrective actions requires business information. How do you get and where do you find this information ? You don't if you don't keep accurate and current records about your business financial activities (bookkeeping).

Users of Financial Information
Who needs financial information about a business besides the owner(s) ?

Users can be grouped into two broad categories namely internal users and external users. Internal users are the managers and the owners and employees who actually work for the business. External users include lenders and other creditors (suppliers), investors, customers, and governmental regulatory and taxing agencies.

Why do they need financial information ?

Users need this information to make knowledgeable decisions. Lenders and other creditors want to make sure that they will be paid back for the credit that they have extended to a business. Even lenders that offer alternatives to small business loans like credit card factoring, more commonly known as business cash advances, will need this information because they will base their funding decisions on your credit card receivables history. By analyzing financial information, they at least have something to base their lending or credit decision on. The days of the "friendly" banker are gone. You need to provide them with financial information as a basis for their loan decisions. A "good ole boy" handshake won't cut it now. Similarly, customers want to make sure that the business they're buying products or services from is going to be around and not be in such a poor financial position as to have to close its doors. Other users have their own reasons for using this financial information.

Since users require financial information to base their decisions on, let's determine what is required to fill this need.

Let's begin with a definition for accounting.
Accounting is the art of analyzing, recording, summarizing, reporting, reviewing, and interpreting financial information.

Let's also define what bookkeeping is and is not. I hate to admit this but I'm going to tell a true story about myself in high school. I thought I was fairly smart back in my high school days and took all the college prep classes. My high school offered bookkeeping classes but I had no clue as to what that course was about. I thought bookkeeping was a course on how to properly organize and stack the reading books in the proper place and shelves in the library using that Dewey decimal code. That is keeping the books isn't it ? Well kinda, but that's not the bookkeeping you're going to learn here. Bookkeeping is one of the components of accounting. Think of accounting as the mom and bookkeeping as one of her children.

Bookkeeping is the process of recording and classifying business financial transactions (activities). In simple language-maintaining the records of the financial activities of a business or an individual. Bookkeeping's objective is simply to record and summarize financial transactions into a usable form that provides financial information about a business or an individual.

Accountants normally plan and set up the accounting and bookkeeping system for a business and turn over the day to day record keeping to the owner or one of his/her employees. In this age of computers, more and more of the daily bookkeeping is being done using bookkeeping software and computers although some businesses still maintain manual records. Due to the reasonable cost of computers and software, I recommend an automated (computer) bookkeeping system. Visit my site for some recommended software. In order to illustrate and understand what is actually being recorded and summarized by a computer bookkeeping system (behind the scenes) my lessons will illustrate the manual method of recording a company's financial information.

Before we start our formal training, I need to present some preliminary information that you should be familiar with. The objective is to give you a little business background information before we dive right in to the lessons.

Types Of Business Organization
One of the first decisions that a person(s) needs to make is how the company should be structured. The four

basic legal forms of ownership for small businesses are a Sole Proprietorship, Partnership, Corporation, and Limited Liability Company. There are advantages and disadvantages as well as income tax ramifications associated with each type of organization. We aren't going to delve in to this area but a brief description of the different types of organization and what they are is needed.

- **Sole Proprietorship**
  Most small business start out as sole proprietorships. These firms are owned by one person who is normally active in running and managing the business.
- **Partnership**
  A partnership is two or more people who share the ownership of a single business. In order to avoid misunderstandings about how profits/losses are shared , who's responsible for what, and other management, ownership, and operating decisions the partners normally have a formal legal partnership agreement.
- **Corporation**
  A corporation is an organization that is made up of many owners who normally are not active in the decision making and operations of the business. These owners are called shareholders or stockholders. Their ownership interest is represented by certificates of ownership (stock) issued by the corporation. Two types of corporations:
  - Regular or "C" Corporation
    Earnings are taxed to the corporation. Shareholders not personally liable for income taxes unless dividends are paid.
  - Subchapter-S
    A special type of corporation allowed by the Internal Revenue Service (IRS) that passes or transfers its earnings to the individual shareholders who personally pay the income taxes.
- **Limited Liability Company (LLC)**
  The LLC is a relatively new type of business structure that combines the benefits of a partnership and corporation.

Factors To Consider
Some Factors and a brief description of what to consider when choosing a type of organization:

- Tax Consequences - Federal and State
  What taxes do you have to pay to the federal and state taxing authorities ?
  Is the business organization a pass-through (income only taxed once) or is the income taxed twice ?
- Ease and cost of formation and recurring registration fees
  What documents do you need to file and what are the initial and recurring costs for the type of organization ?
- Degree of control
  Do you want to call all the "shots" ?
  As a sole owner you get to.
- Liability (personal)
  Do your personal assets need protection from legal liability ?
  Are you willing to be liable for others (partners) ?
- Ability to get money (capital)
  Do you need other investors to get your business "off the ground" ?
- Type of Business
  If your type of profession requires a special license, is it limited to what type of organization that can be selected ?

All the different types of organizations listed above have some unique methods and rules for accounting for their transactions associated with their equity (ownership) accounts. This tutorial in order to keep it simple and since many small businesses start out organized as sole proprietorships will focus on bookkeeping for a **sole**

proprietorship.

Types Of Business Activity
Our society is made up of all kinds of different types of businesses. Some sell products directly to the consumer and are known as retailers. Other businesses called wholesalers warehouse and sell large quantities of products to the retailers who in turn sell it to us (consumer). Businesses like myself provide and sell services to other businesses and individuals. Some businesses even tackle the task of actually producing (make) the products and are called manufacturers.

Many of these businesses are required to maintain and account for inventories of the products that they stock or have on hand. Again this being an introductory tutorial we are not going to cover the practices and procedures used in accounting for inventories. Those wanting to learn about inventories need to refer to my **So, you want to learn Bookkeeping! - Merchandise Inventory Tutorial**. That being the case, the examples in this tutorial will deal with a **service type of business**.

Accounting Period
Believe it or not, a business needs to select an annual tax year. Your two main choices are a **calendar** or **fiscal** tax year. A Calendar Tax Year is 12 consecutive months beginning January 1 and ending December 31. A Fiscal Tax Year is 12 consecutive months ending on the last day of any month except December 31. The calendar tax year is used by most businesses.

A reason a business might choose a fiscal tax year is that they could select an ending month for their fiscal year when business activity is low. This makes the process of what is called closing the books a little easier. Also if a business has inventories, there would be less they would have to count.

For us yanks, our Internal Revenue Service (IRS) has guidelines for what accounting periods can be used based on the types of business organizations such as a corporation, sole proprietorship, partnership, etc. Normally, choosing a calendar year is a safe choice.

Types Of Bookkeeping Systems
A business also needs to determine the type of bookkeeping system that will be used for recording their business transactions. Many small businesses start out using the single entry system.

- **Single Entry System**
  The single entry system is an "informal" accounting/bookkeeping system where a user of this system makes only **one entry** to enter a business financial transaction. It generally includes a daily summary of cash receipts and a monthly record of receipts and disbursements (worksheets).

  A checkbook, for example, is a single entry bookkeeping system where one entry is made for each deposit or check written. Receipts are entered as a deposit and a source of revenue. Checks and withdrawals are entered as expenses. If a manual system is used, in order to determine your revenues and expenses you have to prepare worksheets to summarize your income and categorize and summarize your different types of expenses. Bookkeeping software and spreadsheets are also available to do this for you.

  The emphasis of this system is placed on determining the profit or loss of a business.

  It got its name because you record each transaction only once as either revenue (deposit) or as an expense (check). Since each entry is recorded only once, **debits and credits** (recording method required for the double entry system) **are not used** to record a financial event.

For those interested, the Internal Revenue Service's Publication 583 - "Starting a Business and Keeping Records" has a detailed example of a single entry type of system.

While the single entry system may be acceptable for tax purposes, it **does not provide** a business with all the financial information **needed to adequately report** the financial affairs of a business. In the near future, we'll probably see the single entry system follow the same path as the dinosaur - extinction.

- **Double Entry System**
  The double entry system is the **standard system** used by businesses and other organizations to record financial transactions. Since all business transactions consist of an exchange of one thing for another, double entry bookkeeping **using debits and credits**, is used to show this two-fold effect. Debits and credits are the device that provide the ability to record the entries twice and are explained in more detail later in this tutorial.

  The double entry system also has built-in checks and balances. Due to the use of debits and credits, the double-entry system is self-balancing. The total of the debit values recorded must equal the total of the credit values recorded.

  This system, when used along with the accrual method of accounting, is a **complete accounting system** and focuses on the income statement and balance sheet. This system has worldwide support as the system to use by businesses for recording their financial transactions.

  It got its name because each transaction is recorded in at least two places (accounts) using debits and credits.

Accounting Methods
Another decision faced by a new business is what accounting/bookkeeping method is going to be used to track revenues and expenses. An accounting method is just a set of rules used to determine when and how income and expenses are reported.

If inventories are a major part of a business, the decision is made for the business owner by the Internal Revenue Service (IRS). Some business will be required to use the accrual method of accounting while others may be granted an exception and allowed to use the cash basis along with some special rules.

You're more than likely to encounter both the term **method** and **basis** used when this topic is discussed. In some cases you'll see the term **cash method** used and other cases see the term **cash basis** used. Likewise you'll see the term **accrual method** used and the term **accrual basis** used. They both refer to the same concept and are used interchangeably.

- **Cash Method**
  The cash **method** or **basis** of accounting recognizes revenues (earnings) in the period the cash is received and expenses in the period when the cash payments are made. Actually, two types of cash methods (basis) of accounting exist:
  - **strict** cash method (basis)
  - **modified** cash method (basis)

A strict cash method follows the cash flow exactly. A modified cash method includes some elements from the accrual method of accounting and provides special methods for handling items such as inventory and cost of goods sold, payroll tax expenses and liabilities, and recording and depreciating property and equipment.

Many small businesses, whether they know it or not, are actually using a **modified** cash method.

By concentrating on recording revenues and expenses, the purpose of the cash or modified cash method of accounting is on determining the net income or loss for a period based on the cash received and the cash spent.

Information, such as the amounts billed to customers for products and/or services and not paid, and the amounts billed by suppliers for their products and/or services and not paid **is not normally recorded and maintained** in the "books" using the cash method.

Many small businesses start out using the cash basis rather than the accrual basis of accounting.

Use of the cash basis generally is not considered to be in conformity with generally accepted accounting principles (GAAP). Is this necessarily bad ? No, if no need is foreseen for what are called audited financial statements there's no need for concern. In most cases, audited statements are only required for the "big boys" (companies whose ownership interests are publicly traded). The "little guys" like the ma and pa shops don't need to worry. Still, when possible, a business should strongly consider using the accrual method of accounting.

- **Accrual Method**
  The accrual **method** or **basis** of accounting records income in the period earned and records expenses and capital expenditures such as buildings, land, equipment, and vehicles in the period incurred.

  The purpose of the accrual method of accounting is to properly match income and expenses in the correct period.

  In order to accomplish this, the accrual method of accounting records revenue as earned when the product and/or service is shipped or rendered and invoiced (billed) to customers. Likewise, expenses and capital expenditures are recorded as incurred when the product and or service is shipped or rendered and invoiced (billed) by the supplier.

  Information, such as the amounts billed to customers for products and/or services and not paid, and the amounts billed by suppliers for their products and/or services and not paid **is recorded and maintained** in the "books" using the accrual method. This is the accounting method that is required to be used in order to conform to generally accepted accounting principles (GAAP) in preparing financial statements for external users.

Difference Between The Two Methods
The difference between the two methods used for recording revenues and expenses results from when the business transaction is recorded in the "books" (**timing**). A business using the accrual method will record revenues and expenses in their "books" before a business using the cash method. In other words, **unlike** the **cash method**, they don't wait until they get paid by the customer or wait until they pay a supplier to record the transaction.

Comment: I've heard that "forewarned is fore armed" so here goes. **Cash Flow** and **Profits** are two different "animals". Due to the timing difference as to when revenue and expenses are recorded and when the cash

resulting from the revenue and expenses is actually received or paid out , a business using the accrual method of accounting and reporting a "hefty" profit does not necessarily mean that they have the cash to pay their bills.

Even though the accrual method provides a better measure of profit and loss, many small businesses still use the cash basis of accounting. I think with the advent of easier to use computer accounting and bookkeeping software, we'll see more businesses adopting the accrual basis of accounting.

Relationship Between the Type of Bookkeeping System Used and the Accounting Method Used
What if any is the relationship between the type of bookkeeping system used and the method of accounting ?

The **Single Entry** bookkeeping system is used along with the **Cash Method** of accounting.
Debits and Credits **are not used** to record financial events.

The **Double Entry** bookkeeping system can be used with **both** the **Cash and Accrual** methods of accounting.
Debits and Credits **are used** to record financial events.

So You Know
You can use a **different** accounting method, the cash method or the accrual method, for each business that you set up.

Also, you can keep two sets of books, one on the cash basis and the other on the accrual basis, for the same business. You do; however, have to select one of the methods for tax purposes and continue to use it in the future. This is perfectly legal. It's when you keep two sets of books to hide your true earnings when the trouble begins.

Accounting and Bookkeeping Software
Let's muddy the water about the single and double entry accounting method at least as to how it relates to using bookkeeping and accounting software.

Single or Double Entry ?
Accounting and bookkeeping software programs actually allow the user to make a single (one) entry and the software handles creating the debit and credit entries "behind the scenes". The double-entry system is still there, but it's hidden from the user. The one exception is the general journal where the user does enter debits and credits.

Let's look at a sample transaction of invoicing (billing) a customer to illustrate what I'm talking about.. An invoice to a customer is created and printed and the resulting transaction is **automatically recorded** in the "books" as an increase to the amounts owed by customers and an increase to revenues (sales) using debits and credits.

Wow, since it's automatic, does that mean we don't need to learn about debits and credits later ? Only in your dreams. Although an airplane can be flown on auto-pilot, would you want to be on that plane without a trained pilot ? The same applies to using accounting and bookkeeping software. You need a properly trained bookkeeper or accountant that is also familiar with the software product in order to properly use the software. That ole saying "GIGO" (Garbage In - Garbage Out) definitely applies here.

Let's also muddy the water regarding the cash method and accrual method of accounting.
Some accounting software allows you to convert data back and forth between a cash basis and accrual basis of accounting. As I stated earlier, you do have to select one of the methods for tax purposes and continue to use it in the future.

What's the Recommended Type of Bookkeeping System and Accounting Method ?

Most accountants when asked will recommend that a business use the double entry bookkeeping system and the accrual basis or method of accounting which is based on the **revenue realization principle** and a principle called the **matching concept**. The revenue realization principle states that revenue should be recorded when actually earned.

Don't tell me accountants actually play matchmakers or promote a dating service! No the **matching principle** is recording the revenues earned during a period using the revenue realization principle and matching (offsetting) the revenues with the expenses incurred in generating this revenue. Why is this so important ? All businesses small and large need information to determine how well or badly they are performing; however, if this information is misleading it could lead to false conclusions and unnecessary actions. Show me what you mean.

The following sample business transactions for a mowing and landscaping company will be used to illustrate the accrual basis of accounting/matching concept and the cash basis of accounting.

January xxxx Billed $30,000 To Customers For Services Performed & Completed In January XXXX
January xxxx Received Payments From Customers of $15,000
January xxxx Billed $12,000 by Outside Contractors For Services Performed & Completed In January XXXX
January xxxx Paid Outside Contractors $8,000

February xxxx Received Payments From Customers of $15,000
February xxxx Paid Outside Contractors $4,000

	Cash Basis			Accrual Basis		
	Jan xxxx	Feb xxxx	Total	Jan xxxx	Feb xxxx	Total
Revenue	$15,000	$15,000	$30,000	$30,000	0	$30,000
Expenses	$8,000	$4,000	$12,000	$12,000	0	$12,000
Profit/Loss	$7,000	$11,000	$18,000	$18,000	0	$18,000

Possible Conclusions From The Cash Method

- Made money in January and February.
- Our company is making more profit on the same amount of revenues. We had revenues of $15,000 in both January & February but made a bigger profit in February.
- In February, we must have implemented some expense saving measures or got cheaper prices on our contracted services.

Are any of these conclusions valid ? **No not a one !** The "real" world as illustrated by the **accrual method** shows we had a great January and made $18,000 but February was terrible. We celebrated our great January and sat on our "you know what" and didn't go out and get additional business and mow some more yards and do some more landscaping.

Rules of The Accounting "Game"
In addition to the revenue realization and matching principles or concepts, accounting and bookkeeping is guided by some additional underlying rules.

Why Have Rules ?
All games such as football, baseball, basketball, etc. have rules. Why ? So that everyone plays the game the same way. Playing the Accounting "Game" is no different. What if owners and managers could prepare their business's financial statements the way they felt like ?

If a business was wanting a loan or credit, they would have a tendency to overstate the value of their assets and the value of their business. If it came to taxes (we don't like to have to pay them), let's expense and write off everything. As for measuring performance (profitability) and comparing businesses in the same industry, you'd have no idea as to who was actually doing well and who wasn't. You couldn't even compare your own business from year to year. As to coming up with a reasonable value for what a business was worth, your guess would be as good as mine.

So, to put all businesses on the same playing field, the accounting profession has established some rules and guidelines.

Two notable accounting rule making and standards setting organizations are the United States' Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB). The current accounting rules and standards are continually reviewed, studied, changed, and added to in order to make financial presentations more consistent, comparable, meaningful, and informative.

The following are some of the rules used to "play" the Accounting "Game":

- Accrual Concept (discussed earlier)
  Supports the idea that income should be measured at the time major efforts or accomplishments occur rather than when cash is received or paid.
- Revenue Realization Concept (discussed earlier)
  The revenue recognition principle requires companies to record revenue when it is realized or realizable and actually earned. In other words, at the time the goods are actually sold or the services are rendered.
- Matching Concept (discussed earlier)
  The Matching Principle goes hand in hand with the Revenue Realization Principle. The matching principle is recording the revenues earned during a period using the revenue realization principle and matching (offsetting) the revenues with the expenses incurred in generating this revenue.
- Accounting Period Concept
  This assumption assumes that business operations can be recorded and separated into different time periods such as months, quarters, and years. This is required in order to provide timely information that is used to compare present and past performance.
- Money Measurement Concept
  This assumption assumes accounting measures transactions and events in money and only transactions that can be monetized (stated in a monetary unit such as the dollar) are recorded and presented in financial statements. Simply stated, money is the common denominator (measurement unit) used for reporting financial information.
- Business Entity Concept
  This assumption requires every business to be accounted for separately from the owner. Personal and business-related transactions are kept apart from each other. In other words, the separate personal transactions of owners and others are not commingled with the reporting of the economic activity of the business. One of the first recommendations almost all accountants tell a client is to at least establish a business checking account and to use it to only record their business transactions.

- Going Concern Concept
  This assumption assumes that a business will continue operating and will not close or be sold. It assumes that a business will be in operation for a long time. Based on this assumption, actual costs instead of liquidation values are used for presenting financial information. This assumption is abandoned in the event that a business is actually going out of business.
- Cost Concept
  This principle requires that most assets are recorded at their original acquisition cost and except for a relatively few exceptions (marketable securities) no adjustment is made for increases in market value. In other words, the value of an asset is never "written up" even though the asset may actually be worth more than its cost. On the other hand, the cost is sometimes "written down" for example marketable securities and inventory. See Conservatism Concept.
- Conservatism Concept
  Revenues and gains are recognized slower and expenses and losses are recognized quicker. Accountants have a tendency to stray away from painting too rosy a picture. In other words, if in doubt, err to the side of caution. While accountants don't want to misinform users of financial information, they also don't want to be sued.
- Consistency Concept
  The same accounting methods should be applied from period to period and all changes to more acceptable methods should be well explained and justified. Deviations in measured outcomes from period to period should be the result of deviations in performance not changes in methods.
- Comparable
  Information must be measured and reported in a similar manner by all types of businesses. This allows comparison of the financial statements of different entities (businesses) or comparisons for the same entity (business) over different periods.
- Materiality Concept
  The significance and importance of an item should be considered in order to determine what is reported. Insignificant events need not be measured and recorded.
- Cost-Benefit Convention
  The benefit of providing the financial information should also be weighed against the cost of providing it.
- Industry Practices Convention
  When customary industry practices exists they should be followed and used for financial reporting.

Want a more in depth discussion concerning the rules of accounting and Generally Accepted Accounting Principles ? More About Rules

All lessons and examples in the remainder of this tutorial are all based on the **accrual method of accounting**, the **double entry method** of bookkeeping, and the **sole proprietor** type of business organization.

Let's see if you learned a few terms and anything about the rules for playing the accounting "game". Nothing difficult here, just a few matching exercises that review the rules of accounting and some basic bookkeeping questions.

True/False - Accounting Basics
Matching Quiz - Accounting Rules
Matching Quiz - Accounting Rules II

I'm not going to ring the bell on you, but when you're ready feel free to move on to the next lesson where we "watch the grass grow" and learn some accounting terms.

NEXT-->

So, you want to learn Bookkeeping!

by Bean Counter's Dave Marshall

Lesson 1

The Bookkeeping Language

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In order to discuss your business with your accountant, bookkeeper, banker, or other business associates you need to understand the language. Think back to when you were first learning to read and write. Hopefully for you it's not as long ago as it is for me. You began learning your **ABC's**. After mastering your alphabet and doing a little off key singing, you moved on to learn to use these letters to make words. You then proceeded to learn to make sentences from words and then on to paragraphs, documents, and even term papers. This tutorial is going to use this same approach for introducing you into the world of bookkeeping.

Learning definitions and terminology is about as much fun as watching grass grow, but it is necessary to the understanding of bookkeeping. All I can say is hold your nose, take your medicine, and swallow. After completing the lesson, if you need to, take two aspirin and go to bed.

Your **ABC's** for this lesson are the terminology and definitions used in the Bookkeeping Language. No not ALL of them; just the ONES that you need for this tutorial and those that will enable you to PARTICIPATE and UNDERSTAND when you are discussing financial matters concerning your business. If you're anything at all like me, you like things simple. People also don't need to dazzle and impress me with their wealth of knowledge by

using big words that I don't understand. I don't think I'm one that could dazzle you even if I wanted to. Some of the definitions and terminology you will be presented will have a formal and an informal definition. The formal definition is a definition you would find in an accounting textbook or formal course. The informal definition is my attempt to simplify. In addition, in instances where additional clarification is needed, I'll try to provide an example(s) that you can relate to that will help you attach this term to one of your many brain cells. If you were paying attention, you will have noticed that I did say **many**. Even though you don't know bookkeeping **yet**, I'm sure you're a smart gal or guy.

First, let's start with the **Major Categories** that are used to organize our financial information.

Assets
Formal Definition:The properties used in the operation or investment activities of a business.

Informal Definition:All the good stuff a business has (anything with value). The goodies.

Additional Explanation: The good stuff includes tangible and intangible stuff. Tangible stuff you can physical see and touch such as vehicles, equipment and buildings. Intangible stuff is like pieces of paper (sales invoices) representing loans to your customers where they promise to pay you later for your services or product. Examples of assets that many individuals have are cars, houses, boats, furniture, TV's, and appliances. Some examples of business type assets are cash, accounts receivable, notes receivable, inventory, land, and equipment.

Liabilities
Formal Definition:Claims by creditors to the property (assets) of a business until they are paid.

Informal Definition:Other's claims to the business's good stuff. Amounts the business owes to others.

Additional Explanation: Usually one of a business's biggest liabilities (hopefully they are not past due) is to suppliers where a business has bought goods and services and charged them. This is similar to us going out and buying a TV and charging it on our credit card. Our credit card bill is a liability. Another good personal example is a home mortgage. Very few people actually own their own home. The bank has a claim against the home which is called a mortgage. This mortgage is another example of a personal liability. Some examples of business liabilities are accounts payable, notes payable, and mortgages payable.

Owner's Equity also called Owner's Capital
Comment: Both terms may be used interchangeably. In my tutorial lessons, I may refer to both terms or just use one or the other.

Formal Definition:The owner's rights to the property (assets) of the business; also called proprietorship and net worth.

Informal Definition:What the business owes the owner. The good stuff left for the owner assuming all liabilities (amounts owed) have been paid.

Additional Explanation:Owner's Equity (Capital) represents the owner's claim to the good stuff (assets). Most people are familiar with the term equity because it is so often used with lenders wanting to loan individuals money based on their home equity. Home equity can be thought of as the amount of money an owner would receive if he/she sold their house and paid off any mortgage (loan) on the property.

Revenue (Income), Expenses, Investment, and Draws
Revenues, expenses, investment, and draws are sub categories of owner's equity (capital). Think of owner's equity as a mom named Capital with four children to keep up with (I know she's only got one clinging to her leg but she left Expense, Investment, and Draws at home). The kids are named Revenue, Expense, Investment, and Draws and each kid has one job that they are responsible for in order to earn their allowance. **Kid Revenue** is responsible for keeping track of increases in owner's equity (Ma Capital) and **Kid Expense** is responsible for keeping track of decreases in owner's equity (Ma Capital) resulting from business operations. **Kid Draws** has the job of keeping up with decreases in owner's equity (Ma Capital) resulting from owner withdrawals for living expenses and other personal expenses. **Kid Investment** has the job of keeping up with increases in owner's equity (Ma Capital) resulting from additional amounts invested in the business.

Revenue also called Income
Formal Definition:The gross increase in owner's equity (capital) resulting from the operations and other activities of the business.

Informal Definition:Amounts a business earns by selling services and products. Amounts billed to customers for services and/or products.

Additional Explanation:Individuals can best relate by thinking of revenue as their earnings/wages they receive from their job. Most business revenue results from selling their products and/or services.

Expense also called Cost
Formal Definition:Decrease in owner's equity (capital) resulting from the cost of goods, fixed assets, and services and supplies consumed in the operations of a business.

Informal Definition:The costs of doing business. The stuff we used and had to pay for or charge to run our business.

Additional Explanation:Some examples of personal expenses that most individuals are familiar with are utilities, phone, clothing, food, gasoline, and repairs. Some examples of business expenses are office supplies, salaries & wages, advertising, building rental, and utilities.

Owner's Investments
Formal Definition: Increase in owner's equity (capital) resulting from additional investments of cash and/or other property made by the owner.

Informal definition: Additional amounts, either cash or other property, that the owner puts in his business.

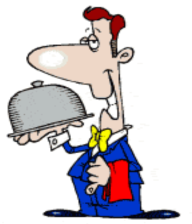
Additional Explanation:Although these amounts can be kept up with as a separate item, they are usually recorded directly in the Owner's Capital Account. In other words, immediately put into Ma Equity's purse.

Owner's Drawing
Formal Definition: Decrease in owner's equity (capital) resulting from withdrawals made by the owner.

Informal definition: Amounts the owner withdraws from his business for living and personal expenses.

Additional Explanation:The owner of a sole proprietorship does not normally receive a "formal" pay check from the business, but just like most of the rest of us needs money to pay for his house, car, utilities, and groceries.

An owner's draw is used in order for the owner to receive money or other "goodies" from his business to take care of his personal bills.



OK you've now been served the meat or as I like to refer to them, "The Big Three and Equity's Kids", so get ready for the potatoes. Personal examples were used to help clarify the terms, but from here on out it's all business terminology and concepts. All the definitions in **red** in this lesson will receive additional attention in later lessons.

Types of Assets

Cash-Monetary items that are available to meet current obligations of the business. It includes bank deposits, currency & coins, checks, money orders, and traveler's checks.

Accounts Receivable-Business claims against the property of a customer arising from the sale of goods and/or services on account.

Notes Receivable-Formal written promises given by customers or others to pay definite sums of money to the business at specified times.

Inventory-Expenditures for items held for resale in the normal course of a business's operations.

Office Supplies-Expenditures for maintaining a supply of on hand supplies such as typewriter, copier, and computer paper, pens, pencils, and special forms.

Land-Expenditures for parcels of the earth. It includes building sites, yards, and parking areas.

Buildings-Expenditures for structures erected on land and used for the conduct of business.

Equipment-Expenditures for physical goods used in a business, such as machinery or furniture. Equipment is used in a business during the production of income.

Furniture includes items needed in a business office such as tables, desks, chairs, and cabinets.

Types Of Liabilities

Accounts Payable-Creditor's claims against the business's property arising from the business's purchase of goods and/or services on account.

Notes Payable-Formal written promises to pay definite sums of money owed at specified times.

Mortgage Payable-Notes payable which are secured by a lien on land, buildings, equipment, or other property of the borrower (your company).

Types of Revenue (Income)

Sale of Products-Amounts earned from the sale of merchandise.

Sale Of Services-Amounts earned from performing services.

Rental Income-Amounts earned from renting properties.

Interest Income-Amounts earned from investments.

Types of Expenses

Supplies-Expenditures for incidental materials needed in the conduct of business, such as office supplies.

Salaries-Expenditures for work performed by employees.

Payroll Taxes-Expenditures for taxes based on wages paid to employees.

Advertising-Promotional expenditures, such as newspapers, handbills, television, radio and mail.

Utilities-Expenditures for basic services needed to function in the modern world, such as water, sewer, gas, electricity and telephone. Most businesses track the amount spent for each type of utility service.

Building Rental-Expenditures paid to an owner of property (building) for use of the property. A rental agreement called a lease contains the terms.

Maintenance & Repairs-Expenditures paid to repair and or maintain buildings and/or equipment.

Other Terms Necessary for Understanding and Learning Bookkeeping

Accounting Equation-mathematical expression of the relationship of property and property rights. Also called the Balance Sheet Equation.

The equation may be expressed in three forms:

- Abbreviated or Simple Version:
Property = Property Rights
- Expanded Version:
Assets = Liabilities + Owner's Equity (Capital)
- Fully Expanded Version:
Assets = Liabilities + Beginning Owner's Equity (Capital) + Additional Owner Investments + Revenues - Expenses - Draws

Transaction-Any event or condition that must be recorded in the books of a business because of its effect on the financial condition of the business, such as buying and selling. A business deal or agreement.

Single Entry-Type of "informal" accounting/bookkeeping system where a user of this system makes only **one entry** to enter a business financial transaction. It generally includes a daily summary of cash receipts and a monthly record of receipts and disbursements (worksheets).

Double Entry-Type of accounting/bookkeeping system that requires every transaction to be recorded in at least two places (accounts) using a debit and a credit. Every transaction is recorded in a "formal" journal as a debit entry in one account, and as a credit entry in another account. Periodically, usually monthly, the summarized balances from the journals are posted (transferred) to a formal business record called the general

ledger.

Cash Method (Basis) of Accounting-method of accounting that recognizes revenues (earnings) in the period the cash is received and expenses in the period when the cash payments are made.

Accrual Method (Basis) of Accounting-method of accounting that records income in the period earned and records expenses and capital expenditures such as buildings, land, equipment, and vehicles in the period incurred.

Debit-

- An entry in the financial books of a firm that increases an asset or an expense or an entry that decreases a liability, owner's equity (capital) or income.
- Also, an entry entered on the left side (column) of a journal or general ledger account.

- Let's combine the two above definitions into one complete definition.

An entry (amount) entered on the left side (column) of a journal or general ledger account that increases an asset, draw or an expense or an entry that decreases a liability, owner's equity (capital) or revenue.

Credit-

- An entry in the financial books of a firm that increases a liability, owner's equity (capital) or revenue, or an entry that decreases an asset or an expense.
- Also, an entry entered on the right side (column) of a journal or general ledger account.

- Let's combine the two above definitions into one complete definition.

An entry (amount) entered on the right side (column) of a journal or general ledger account that increases a liability, owner's equity (capital) or revenue, or an entry that decreases an asset, draw, or an expense.

Don't worry double entry, debits, and credits are discussed and explained in future lessons. I only wanted to introduce and make you aware of these terms because they are critical terms for understanding the double entry bookkeeping system.

Posting-Process of transferring balances from bookkeeping records called journals to a "final" bookkeeping record called the general ledger.

T-Account-a skeleton outline of an account which provides the same basic data as a formal ledger account. Used as a teaching aid.

Account-a separate record for each type of asset, liability, equity, revenue, and expense used to show the beginning balance and to record the increases and decreases for a period and the resulting ending balance at the end of a period.

Contra Account-an account which offsets and reduces or offsets the balance of another account.

- A contra-asset account has a credit balance and offsets and decreases the debit balance of the related asset account. An example account is Accumulated Depreciation which reduces the equipment account to arrive at the equipment's net value.
- A contra-liability account has a debit balance and offsets and decreases the credit balance of the related liability account. An example accounts is the bond discount account that reduces the bonds payable account to

arrive at the bond's net value.

Balance Sheet Account-a type of account that is included in the Balance Sheet; namely the Assets, Liabilities, and permanent Equity Accounts.

Permanent or Real Account-another term used to refer to the balance sheet accounts.

Income Statement Account-a type of account that is included in the Income Statement; namely the Revenue and Expense Accounts.

Temporary Account-another term used to refer to the income statement accounts. The accounts are called temporary due to the fact that their balances are set to zero when the books are closed.

Closing the Books-process of transferring the balances from the temporary income statement accounts (revenues and expenses) to the permanent balance sheet equity account(s).

Profit-amount a business's revenues exceed (greater than) expenses. In other words, the amounts we earned were greater than our expenses.

Loss-amount a business's expenses exceed (greater than) revenues. In other words, we earned less than we spent.

Property-is another term for assets. In future lessons the term property and assets both mean the same thing-all the good stuff a business has.

Current Asset-cash and other assets normally expected to be converted to cash or used up usually within a year.

Current Liability-amounts owed (liabilities) that need to be paid or settled usually within a year.

Working Capital-net difference between current assets and current liabilities.
Working Capital = Current Assets - Current Liabilities

Major Types of Accounting & Bookkeeping Records and Documents

General Ledger-A book containing the accounts and balances for all of a business's assets, liabilities, equity, revenue, and expense accounts.

Chart Of Accounts-A coded listing of all the accounts in the general ledger.

Journals-A preliminary record where business transactions are first entered into the accounting system. The journal is commonly referred to as the book of original entry.

Specialized Journals-Journals used to initially record special types of transactions such as sales, cash disbursements, and cash receipts in their own journal.

Trial Balance-A worksheet listing of all the accounts appearing in the general ledger with the dollar amount of the debit or credit balance of each. Used to make sure the books are "in balance" -total debits and credits are equal.

Subsidiary Ledgers-A separate record set up to record the individual items relating to a single general ledger account (control account). Examples include an accounts receivable and accounts payable ledger.

Worksheets-Forms which are used to summarize all the information necessary to complete the end-of-period financial reports and prepare other financial analysis.

Invoice-a business document showing the names and addresses of the buyer and the seller; the date and terms of the sale; the description, quantity, unit price, and total price of goods purchased or sold and the method of delivery.
Selling business refers to this document as a Sales Invoice.
Buying business refers to this document as a Supplier Invoice.

Receiving Report-A document originated by the buying business listing the quantities and condition of the goods and/or services received from a supplier.

Sales Order-A documented originated by the seller listing the goods and/or services ordered by a customer and other information such as prices and delivery dates.

Purchase Order-A document originated by the purchaser (buyer) requesting the supplier to ship goods or perform services.

Check Book-Formal record of all checks written, deposits, bank charges, and miscellaneous charges and credits.

Check-A written order directing a bank to pay cash from the account of the writer (drawer) of the check.

Bank Reconciliation-The process of bringing the checkbook and bank statement balances into agreement.

Bank Statement-A copy of the bank's record of the business's account showing the balance of the account at the beginning of the month, the deposits and withdrawals (mostly checks) made during the month, service charges, and the balances at the end of the month.

Financial Statements-Accounting reports prepared periodically to inform the owner, creditors, and other interested parties as to the financial condition and operating results of the business. The three basic financial statements are:
Balance Sheet-The financial statement which shows the amount and nature of business assets, liabilities, and owner's equity (capital) as of a specific point in time. It is also known as a Statement Of Financial Position or a Statement Of Financial Condition.
Income Statement-The financial statement that summarizes revenues and expenses for a specific period of time, usually a month or a year. This statement is also called a Profit and Loss Statement or an Operating Statement.
Capital Statement-The financial report that summarizes all the changes in owner's equity (capital) that occurred during a specific period.
Statement of Changes in Financial Position-The financial statement that reports the sources and uses of cash or working capital for a specific period of time, normally a year.

The definitions and terminology presented in this lesson are by no means all the terminology that is used in the field of accounting, but are some of the major terms that you might encounter and are needed to complete this tutorial. If curious or wanting to know the meaning of other financial or accounting terms check out these sites that provide bookkeeping and accounting definitions.

Let's see if you need to take two aspirin and go to bed. Nothing difficult here, just a few matching and anagram (jumbled word) exercises that review bookkeeping terms.

Matching Terms Quiz 1	Matching Terms Quiz 4
Matching Terms Quiz 2	Matching Terms Quiz 5
Matching Terms Quiz 3	Anagram Terms Quiz

Don't worry if you don't understand every definition that has been presented in this lesson. I tossed you in the water to get you wet, but I'm not going to let you drown. Swimming instructions will be provided in other lessons and your lifeguard (me) will be watching out for you. The lessons that follow will clear up some of the more complex definitions and concepts with examples and additional discussions. All the definitions in **red** in this lesson will receive additional attention.

OK, that's enough of having fun watching the grass grow, let's move on.

<--BACK **NEXT-->**

Introduction	Lesson 1	Lesson 2	Lesson 3	Lesson 4	Lesson 5	Lesson 6	Lesson 7

Bean Counter

So, you want to learn Bookkeeping!

by Bean Counter's Dave Marshall

Lesson 2

Property and Property Rights

Introduction	Lesson 1	Lesson 2	Lesson 3	Lesson 4	Lesson 5	Lesson 6	Lesson 7

Bean Counter

Your chef, namely me (I know I was a lifeguard but now I'm a chef), is about to divulge a secret recipe. I know

you've been waiting to get the Colonel's secret recipe for Kentucky fried chicken. Sorry to disappoint you, but this recipe is actually a simple equation and lays the foundation on which double entry bookkeeping is built.

This equation is called **the**
ACCOUNTING EQUATION
and is also referred to as the **Balance Sheet Equation**

The equation may be expressed in three forms:

- Abbreviated or Simple Version:

Property = Property Rights

- Expanded Version:

Assets = Liabilities + Owner's Equity (Capital)

- Fully Expanded Version:

Assets = Liabilities + Beginning Owner's Equity (Capital) + Additional Owner Investments + Revenues - Expenses - Draws

The two basic elements of any organization are what it owns (property) and who it owes (property rights). Remember from Lesson 1 (it wasn't that long ago) that property and assets are both terms that define the same thing and that property rights is an abbreviated term for liabilities and equity. You'll probably notice that I use these terms interchangeably through out the tutorial.

The simple or abbreviated accounting equation (Property = Property Rights) states that the property of the business must equal the rights to the property or stated another way the claims against the property. In other words, we want to track not only the goodies (property) we get, but also how we acquired or got them and from whom (source).

Double Entry Bookkeeping System
Do you also recall that term **double entry** that we mentioned in the Introduction and also in Lesson 1 ? **Double Entry** is a type of accounting/bookkeeping system that requires every transaction to be recorded in at least two places (accounts) using debits and a credits (discussed later) to represent increases and decreases.

Well this equation is what **double entry** is all about. We make two entries for every business transaction. These entries represent increases or decreases in property (assets) and/or property rights (liabilities and owner's equity).

In other words the double entry system based on the Accounting Equation allows us to track:

(1) What We Got and What Went (Property)
and
(2) From Whom and To Whom (Property Rights)

Claims To The Assets ("Good Stuff")

Who has a right or claim to the business's property ? Claims to the property (assets) arise from two sources:

- Creditors of the business (liabilities)

Those from whom the business borrows from or buys from on credit are called creditors. The creditors have a claim to the property (assets) of the business until they are paid. These creditor claims are called liabilities. Two common types of creditors are a business's suppliers and banker.

- Owner(s) of the business (owner's equity)

Yes the owner(s) also has a claim to the property (assets) for property (assets) invested into their business and any increases or decreases resulting from operating the business. Remember in Lesson 1 we discussed Owner's Equity ("Ma Capital") and also her four kids Revenue, Investment, Expense, and Draws. If you recall, we learned that revenues and additional owner investments increase owner's equity while expenses and draws decrease owner's equity.

Another way to think about these increases and decreases to equity is to relate it to your personal financial situation. Your earnings (revenue) increase your personal wealth (equity) and your living expenses and draws (money you give your wife) decrease your personal wealth (equity). Sorry gals that I picked on you for my example of draws.

Besides monitoring and keeping up with the activity of her four "Kids", "Ma Capital" also has the responsibility of summarizing the activity of her four kids (revenue, expense, investment, and draws) for a period of time (monthly or yearly). Think of Owner's Equity (Capital) as Ma's Purse. Ma summarizes all the increases and decreases resulting from revenues, expenses, investments, and draws and puts the balance in her purse (capital). This summarizing activity is called **Closing the Books**. Closing The Books will be discussed more in a later lesson.

It should now be apparent that the assets (property) are subject to two kinds of claims (property rights), those arising from the rights (claims) of creditors (liabilities) and those arising from the rights (claims) of the owner (owner's equity).

Developing Our Different Versions Of the Accounting Equation

Since
(1) Property = Assets and
(2) Property Rights (Claims to the Property) = Liabilities + Owner's Equity (Capital),

the simple or abbreviated accounting equation Property = Property Rights expanded or restated now becomes

Assets = Liabilities + Owner's Equity (Capital).

We're now going to concentrate on the **Owner's Equity (Capital)** section of the equation. If you recall, the balance of Owner's Equity ("Ma Capital") is affected by her kids Revenue, Expense, Investment, and Draws.

Businesses normally operate with the objective of making a profit. Profit is determined by using two of "Ma Capital's Kids" (Revenue and Expense) and subtracting the expenses from revenue (income). Any profits made by a business go to the owner. Therefore, the effects of revenue (income) and expenses are shown under the Owner's Equity section of the accounting equation. An increase in revenues represents an increase in profit and therefore an increase in Owner's Equity ("Ma Capital"). An increase in expenses represents a decrease in profits and therefore a decrease in Owner's Equity ("Ma Capital").

"Kid Draws" and "Kid Investment" also affect the Owner's Equity ("Ma Capital") section of the accounting equation. Draws decrease Owner's Equity ("Ma Capital") and additional investments increase Owner's Equity ("Ma Capital").

Summary of The Effects of "Ma's Kids" on Owner's Equity ("Ma Capital"):

- Owner Investments ("Kid Investment") increase Owner's Equity ("Ma Capital")
- Revenues ("Kid Revenue") increase Owner's Equity ("Ma Capital")
- Expenses ("Kid Expense") decrease Owner's Equity ("Ma Capital")
- Owner's Draws ("Kid Draws") decrease Owner's Equity ("Ma Capital")

Using the above information we can present this information in the following equation:

Current Owner's Equity (Capital) = Beginning Owner's Equity (Capital) + Owner's Investments + Revenues - Expenses - Draws

This new **Owner's Equity Equation** illustrates the relationships and effects investments, revenue, expense, and draws have on **Owner's Equity (Capital)**.

Let's take this one final step to arrive at our **Fully Expanded Accounting Equation** which includes all the components that make up and affect Owner's Equity (Capital).

Our Expanded Accounting Equation Assets = Liabilities + Owner's Equity (Capital)
expanded or restated now becomes our **Fully Expanded Version**

Assets = Liabilities + Beginning Owner's Equity (Capital) + Additional Owner Investments + Revenues - Expenses - Draws.

In the Expanded Version of the Accounting Equation, "Ma Capital's Kids" are hiding behind her skirt. There there; you just don't see them. The fully expanded version brings them out of hiding and shows you their effects on Owner's Equity ("Ma Capital").

While all three of the equations illustrate the relationship of property and property rights, the accounting equation **most often used and referred to** is the Expanded Equation:

Assets = Liabilities + Owner's Equity

Observation: In using the expanded accounting equation, if two of the three components are known, the third can easily be calculated by using some simple Algebra to rearrange the equation. Don't worry, you're not going to get an Algebra Lesson.

The accounting equation can be expressed in the following different ways:

- Asset emphasis:

Assets = Liabilities + Owner's Equity
- Equity emphasis:

Owner's Equity = Assets - Liabilities
- Liability emphasis:

Liabilities = Assets – Owner's Equity

So, You Can:

- Calculate Assets if Liabilities and Owner's Equity are known

Assets = Liabilities + Owner's Equity (Normal Formula)
- Calculate Owner's Equity if Assets and Liabilities are known

Owner's Equity = Assets - Liabilities
- Calculate Liabilities if Assets and Owner's Equity are known

Liabilities = Assets - Owner's Equity

Let's see if I fibbed.

If Liabilities are 70,000 and Owner's Equity is 30,000 what is the value of the Assets ?
Assets = Liabilities + Owner's Equity
Assets = 70,000 + 30,000
Assets= 100,000

If Assets are 100,000 and Liabilities are 70,000 what is the value of our Owner's Equity ?
Owner's Equity = Assets - Liabilities
Owner's Equity = 100,000 - 70,000
Owner's Equity = 30,000

And lastly, if Assets are 100,000 and Owner's Equity is 30,000 what is the value of our Liabilities ?.
Liabilities = Assets - Owner's Equity
Liabilities = 100,000 - 30,000
Liabilities = 70,000

I will use both the simple or abbreviated version (Property = Property Rights) and the expanded version (Assets = Liabilities + Owner's Equity) of the Accounting Equation in this lesson to demonstrate bookkeeping concepts. Lesson 3 continues to explore the Fully Expanded Accounting Equation.

Types Of Transactions Table Using the Simple (Abbreviated) Accounting Equation

Property = Property Rights

Navigation:
Interactive Links are provided in this table in the Examples Of Transactions Column.
- Click on the Underlined Number (1,2,3,etc.) links to navigate to the Transaction Analysis Using The Simple Accounting Equation Table to see a sample transaction that illustrates the affect of this type of transaction on our Simple Accounting Equation.

Let's use our simple or abbreviated accounting equation and get an overview of the types of transactions that can occur and their effects on our simple equation. The table illustrates the four basic types of transactions represented by the letters a. b. c. and d. and their effects on our simple or abbreviated accounting equation.

Property =		**Property Rights**		**Examples Of Transactions**
Left Side =		**Right Side**		
(a)	Increase In Property	**(a)**	Increase In Property Rights	#1 #2 #4 #5 #10

(b)	Decrease In Property	**(b)**	Decrease In Property Rights	#3 #6 #7
(c)	Increase In One Type Of Property			#8
(c)	Decrease In Another Type Of Property			#8
		(d)	Increase In One Type Of Property Rights	#9
		(d)	Decrease In Another Type Of Property Rights	#9

What does the table tell us ?

Although transactions may require increases to both sides of the equation (left and right side both increase - transaction type **(a)**, decreases to both sides of the equation (left and right side both decrease - transaction type **(b)**, or an increase and decreases on the same side of the equation (increase and decrease on the left side - transaction type **(c) or** an increase and decrease on the right side transaction **(d)**, the **equation always balances**.

Did you also notice we made two entries for each of the example transactions illustrated in our table ? There's that **double entry** thing again. The table also illustrates that by using double entry bookkeeping the dollar amount of the property will at all times equal the dollar amount of the property rights.

Business Transactions and Their Effects on The Accounting Equation

The remainder of this lesson will be examples used to demonstrate recording transactions using the double entry bookkeeping system in conjunction with our accounting equation.

We are now going to analyze the effects of typical types of business transactions and how they affect our Accounting Equation. We will use the fictional ABC business which is a service type business (lawn mowing), sole proprietorship, uses double entry accounting, and the accrual basis of accounting for our example.

Our analysis will use both the simple or abbreviated and expanded Accounting Equation to demonstrate the transaction effects.

ABC Transactions

A brief analysis of the effects follows each transaction. A more in depth analysis is presented in later lessons.

1. ABC mows a client's yard and receives a check from the customer for $50 for the service provided.
The property cash is increased and the owner's property rights (claims to the property) are increased.

2. ABC purchases $100 worth of office supplies for inventory and stores them in their storage room. The office supply store gives them an invoice that allows them to pay for them in 15 days (on account).
The property office supplies is increased and the creditor's property rights (claims to the property) are increased.

3. ABC places an ad in the local newspaper receives the invoice from the supplier and writes a check for $25 to the newspaper.
The property cash is decreased and the owner's property rights (claims to the property) are decreased.

4. ABC purchases five mowers for $10,000 and finances them with a note from the local bank.
The property equipment (mowers) is increased and the creditor's property rights (claims to the property) are increased.

5. ABC mows another customer's yard and sends the customer a bill (invoice) for $75 for the service they performed. They allow their customer 10 days to pay them for this service (on account).
The property amounts owed by customers is increased and the owner's property rights (claims to the property) are increased.

6. The owner of ABC needs a little money to pay some personal bills and writes himself a check for $500.
The property cash is decreased and the owner's property rights (claims to the property) are decreased.

7. ABC pays the office supply company $100 with a check for the office supplies that they charged (promised to pay).
The property cash is decreased and the creditor's property rights (claims to the property) are decreased.

8. ABC receives a check from the customer who they billed (invoiced) $75 for services and allowed 10 days to pay.
The property cash is increased and the property amounts owed by customers are reduced. This is actually a swap of one type of property for another.

9. ABC purchased some mulch for $60 and received an invoice from their supplier who allows them 15 days to pay. The mulch was used on a customer's yard.
The property right amount owed a supplier is increased and the owner's claim on the property rights (claims to the property) is decreased.

10. ABC bills (prepares an invoice) the customer $80 for the mulch and mowing his yard and receives a check for $80 from the customer.
The property cash is increased and the owner's property rights (claims to the property) are increased.

Transaction Analysis Using The Simple (Abbreviated) Accounting Equation

Property = Property Rights

Navigation:
Interactive Links are provided in this table.
- Click on the Underlined Return To Types Of Transactions Table Link to Return To The Types of Transaction Table.

Transactions	Property = Left Side		Property Rights Right Side	
	Increase	Decrease	Decrease	Increase
1. ABC mows a client's yard and receives a check from the customer for $50 for the service provided. Return To Types Of Transactions Table	50			50
2. ABC purchases $100 worth of office supplies and stores them in their storage room. The office supply store gives them an invoice that allows them to pay for them in 15 days (on account). Return To Types Of Transactions Table	100			100
3. ABC places an ad in the local newspaper receives the invoice from the supplier and writes a check for $25 to the newspaper. Return To Types Of Transactions Table		25	25	
4. ABC purchases five mowers for $10,000 and finances them with a note from the local bank. Return To Types Of Transactions Table	10,000			10,000
5. ABC mows another customer's yard and sends the customer a $75 bill (invoice) for the service they performed. They allow their customer ten (10) days to pay them for this service (on account). Return To Types Of Transactions Table	75			75
6. The owner of ABC needs a little money to pay some personal bills and writes himself a check for $500. Return To Types Of Transactions Table		500	500	
7. ABC pays the office supply company $100 with a		100	100	

check for the office supplies that they charged (promised to pay). Return To Types Of Transactions Table				
8. ABC receives a check from the customer who they billed (invoiced) $75 for services and allowed 10 days to pay. Return To Types Of Transactions Table	75	75		
<>9. ABC purchased some mulch for $60 and received an invoice from their supplier who allows them 15 days to pay. The mulch was used on a customer's yard. Return To Types Of Transactions Table			60	60
10. ABC bills (prepares an invoice) the customer $80 for the mulch and mowing his yard and receives a check for $80 from the customer. Return To Types Of Transactions Table	80			80
Totals	$10,380 Increase	$700 Decrease	$685 Decrease	$10,365 Increase
Total Net Changes	$9,680 Increase		$9,680 Increase	

Types Of Transactions Table Using the Expanded Accounting Equation
Assets = Liabilities + Owner's Equity

Navigation:
Interactive Links are provided in this table in the Examples Of Transactions Column.

- Click on the Underlined Number (1,2,3,etc.) links to navigate to the Transaction Analysis Using The Expanded Accounting Equation Table to see a sample transaction that illustrates the affect of this type of transaction on the Expanded Accounting Equation.

Now let's use our expanded accounting equation and get an overview of the types of transactions that can occur and their effects on our expanded equation. The table illustrates the four basic types of transactions represented by the letters a. b. c. and d. and their effects on our expanded accounting equation.

Assets =	**Liabilities + Owner's Equity**	**Examples Of Transactions**
Left Side =	**Right Side**	

(a)	Increase In Assets	**(a)**	Increase In Liabilities or Owner's Equity	#1 #2 #4 #5 #10
(b)	Decrease In Assets	**(b)**	Decrease In Liabilities or Owner's Equity	#3 #6 #7
(c)	Increase In One Type Of Assets			#8
(c)	Decrease In Another Type Of Asset			#8
		(d)	Increase In One Type of Liability or Owner's Equity	#9
		(d)	Decrease In Another Type of Liability or Owner's Equity	#9

Transaction Analysis Using The Expanded Accounting Equation

Assets = Liabilities + Owner's Equity

Navigation:
Interactive Links are provided in this table.
- Click on the Underlined Return To Types Of Transactions Table Link to Return To The Types of Transaction Table.
- Click on the Underlined Dollar Amount Link to navigate to the Equity Table and see the effects of Revenue, Expenses, or Draws.

Transactions	Assets = Left Side		Liabilities + Right Side		Owner's Equity Right Side	
	Increase	Decrease	Decrease	Increase	Decrease	Increase
1. ABC mows a client's yard and receives a check from the customer for $50 for the service provided. Return To Types Of Transactions Table	50					50
2. ABC purchases $100 worth of office supplies and stores them in their storage room. The office supply store gives them an invoice that allows them to pay for them in 15 days (on account). Return To Types Of Transactions Table	100			100		

3. ABC places an ad in the local newspaper receives the invoice from the supplier and writes a check for $25 to the newspaper. Return To Types Of Transactions Table		25			25	
4. ABC purchases five mowers for $10,000 and finances them with a note from the local bank. Return To Types Of Transactions Table	10,000			10,000		
5. ABC mows another customer's yard and sends the customer a $75 bill (invoice) for the service they performed. They allow their customer ten (10) days to pay them for this service (on account). Return To Types Of Transactions Table	75					75
6. The owner of ABC needs a little money to pay some personal bills and writes himself a check for $500. Return To Types Of Transactions Table		500			500	
7. ABC pays the office supply company $100 with a check for the office supplies that they charged (promised to pay). Return To Types Of Transactions Table		100	100			
8. ABC receives a check from the customer who they billed (invoiced) $75 for services and allowed 10 days to pay. Return To Types Of Transactions Table	75	75				
9. ABC purchased some mulch for $60 and received an invoice from their supplier who allows them 15 days to pay. The mulch was used on a customer's yard. Return To Types Of Transactions Table				60	60	
10. ABC bills (prepares an invoice) the customer $80 for the mulch and mowing his yard and receives a check for $80 from the customer. Return To Types Of Transactions Table	80					80

Totals	$10,380	$700	$100	$10,160	$585	$205
Net Change	$9,680 Increase		$10,060 Increase		$380 Decrease	
Total Net Changes	$9,680 Increase		$9,680 Increase			

Equity Table

Analysis of the Effects of Revenue, Expense, and Draws ("Ma Capital's Kids") on Owner's Equity (Capital)

Navigation:
Interactive Links are provided in this table.

- To Return To The Analysis Using The Expanded Accounting Equation Table Click on the Underlined Dollar Amount.

In the previous table, we entered all the transactions that affected Owner's Equity under one heading; namely, Owner's Equity and disregarded whether it was a revenue, expense, or draw item. The following table illustrates where the transaction affecting Owner's Equity would actually be entered.

This table is provided to help illustrate the effects that "Ma Capital's "Kids" Revenue, Expense, and Draw have on Owner's Equity ("Ma Capital"). Of course only the sample transactions that affect Owner's Equity have been included.

Instead of recording transactions directly to "Ma Capital" (Owner's Equity), proper bookkeeping actually uses her kids revenue, expense, and draws to record the increases and decreases to "Ma Capital" (Owner's Equity) in order to provide us with the answers to the how and why the owner's claim to the business's property increased or decreased.

	"Ma Capital"		"Ma's Kids"		
Proper Recording Actually Uses Revenue, Expense & Draws Instead Of Owner's Equity	Original Recording		Proper Recording Uses		
Transactions	Owner's Equity Right Side		Revenue	Expense	Draw
	Decrease	Increase	Revenue Increases Resulting In an Increase to Equity	Expenses Increase Resulting In a Decrease to Equity	Draws Increase Resulting in a Decrease to Equity

1. ABC mows a client's yard and receives a check from the customer for $50 for the service provided.		50	50		
3. ABC places an ad in the local newspaper receives the invoice from the supplier and writes a check for $25 to the newspaper.	25			25	
5. ABC mows another customer's yard and sends the customer a $75 bill (invoice) for the service they performed. They allow their customer ten (10) days to pay them for this service (on account).		75	75		
6. The owner of ABC needs a little money to pay some personal bills and writes himself a check for $500.	500				500
9. ABC purchased some mulch for $60 and received an invoice from their supplier who allows them 15 days to pay. The mulch was used on a customer's yard.	60			60	
10. ABC bills (prepares an invoice) the customer $80 for the mulch and mowing his yard and receives a check for $80 from the customer.		80	80		

What should we pick up and learn from these tables and example transactions recorded in the tables ?

Here's What

1. How different types of business transactions affect the Accounting Equation.
2. How each transaction was **recorded twice** illustrating **double entry** bookkeeping.
3. The total amounts for the tables prove the self-balancing nature of the Accounting Equation.
4. How transactions may require increases to both sides of the equation (increase left side and increase right side), decreases to both sides of the equation (decrease left side and decrease right side), or an increase and decreases on the same side of the equation (increase and decrease the left side or increase and decrease the right side), but the equation must always balance.
5. The Equity Table illustrates that, while transactions that affect Owner's Equity could be entered using only one column, additional useful information is obtained by breaking Owner's Equity into its component parts (kids) using the revenue, expense, and draws categories to record the transactions.
6. That revenues increase owner's equity while expenses and draws decrease owner's equity.

Let's see if anything stuck to your brain cells about the accounting equation and the effects of typical types of business transactions. I won't be cruel. Well, maybe a little, because you'll be analyzing the same transactions that we just got through reviewing. The only difference is that instead of me analyzing them, it's

up to you.

Oh no, you're back in the interrogation room ! Let's see how we'll you do on these skill tests about how transactions affect the Accounting Equation.

Transactions and the Expanded Accounting Equation Skills Test
Uses Owner's Equity to record all of the transactions that affect Owner's Equity.
Transactions and the Fully Expanded Accounting Equation Skills Test
Uses Revenue, Expense, and Draws ("Ma's Kids") to record the transactions that affect Owner's Equity.

Note:Skill Tests use JavaScript which is enabled on most computers.

Comment: Before we end our discussion of equations, another equation that you may run across is what I call the **Debit and Credit Equation**. The Debit and Credit Equation is just a variation (rearranged version) of the Fully Expanded Accounting Equation. Some simple Algebra was used to rearrange the major types of accounts.

So you know it looks like this:

Debit and Credit Equation
Assets + Draws + Expenses = Liabilities + Owner's Equity + Revenue
Debit Balance Accounts = Credit Balance Accounts

In this equation all the normal debit balance accounts are on the left side of the equal sign and all the normal credit balance accounts are on the right side of the equal side. This equation is sometimes used to help understand Debits and Credits which we'll be discussing in our next lesson.

Have Mercy I'm ready for a break ! We've covered quite a bit in this lesson. I'll have to agree you do deserve a break. See You In Lesson 3 where we cover Debits and Credits.

So, you want to learn Bookkeeping!

by Bean Counter's Dave Marshall

Lesson 3

Debits and Credits

Introduction	Lesson 1	Lesson 2	Lesson 3	Lesson 4	Lesson 5	Lesson 6	Lesson 7
Bean Counter							

I thought about calling this lesson "The Revenge of The Nerds". The nerds, in this case, being us accountant types. Students and others studying accounting and bookkeeping probably think that debits and credits are our (accountants) way of paying them back for poking fun at our profession. Actually, there's really nothing difficult about debits and credits. It's just our method used to record business transactions.

For Every Action There Is An Opposite Reaction

Stop Right There! You're not going to start teaching physics are you ? No, but accounting and bookkeeping have a similar rule. Accounting and Bookkeeping's similar rule is:

For Every Debit There Is A Credit

OR

Debits = Credits

This rule is the basis for the double entry bookkeeping system. If you recall, the double entry system is an accounting system that requires at least two entries to record a financial transaction.

What enables the double entry accounting system to work ? In two words **Debits** and **Credits**.

We learned in Lesson 2 that the double entry system based on the Accounting Equation allows us to track:

(1) What We Got and What Went (Property)
and
(2) From Whom and To Whom (Property Rights)

We've already discussed transactions and how they increase or decrease the assets, liabilities, and owner's equity of a business and their effects on the **Accounting Equation** in Lesson 2. All we're going to do now is give these increases and decreases an official bookkeeping name and definition. Can you guess the names of the terms that we're going to associate with increases and decreases ? I hope you said debit and credit.

Definitions of Debits and Credits

Debit (Left)

- An entry in the financial books of a firm that increases an asset, draw, or an expense or an entry that decreases a liability, owner's equity (capital) or income.
- Also, an entry entered on the left side (column) of a journal or general ledger account.

- Let's combine the two above definitions into one complete definition.

An entry (amount) entered on the left side (column) of a journal or general ledger account that increases an asset, draw or an expense or an entry that decreases a liability, owner's equity (capital) or revenue.

Credit (Right)

- An entry in the financial books of a firm that increases a liability, owner's equity (capital) or revenue, or an entry that decreases an asset, draw, or an expense.
- Also, an entry entered on the right side (column) of a journal or general ledger account.

- Let's combine the two above definitions into one complete definition.

An entry (amount) entered on the right side (column) of a journal or general ledger account that increases a liability, owner's equity (capital) or revenue, or an entry that decreases an asset, draw, or an expense.

Many accounting text books discuss debits and credits by concentrating on the simplistic definition of debits and credits. Debit means left, credit means right. In other words, a debit is a number written on the left side of an account and a credit is a number written on the right side of an account. While this is true, it only tells us on what side of an account we should place an entry. We also need to know **when is an entry a debit** (entered on the left side) and **when is an entry a credit** (entered on the right side) and how the entry **affects the account**.

This is where the key terms **increase** and **decrease** and **the type of account** (asset, liability, owner's equity, revenue, and expense) come into play. The term debit does not mean increase or decrease, nor does the term credit mean increase or decrease until the term is also **associated with a type of account**. In other words, debit does not always mean an increase nor does credit always mean a decrease , or vice versa. Also, the terms debit and credit do not refer to something good or bad.

In my opinion, good usable definitions of the terms debit and credit contain all three of the elements we just discussed:

- Left Side / Right Side
- Increase / Decrease
- Associated Type Of Account

Can you guess what definitions I prefer to use for debit and credit from the three definitions that I presented earlier ? The ones that contains all three elements.

- **Debit**
An entry (amount) entered on the **left side** (column) of a journal or general ledger account that **increases** an **asset, draw or an expense** or an entry that **decreases** a **liability, owner's equity (capital) or revenue**.
- **Credit**
An entry (amount) entered on the **right side** (column) of a journal or general ledger account that **increases** a **liability, owner's equity (capital) or revenue**, or an entry that **decreases** an **asset, draw, or an expense**.

Let's See How Debits and Credits are Related To Our Accounting Equations

Remember our Accounting Equations ?

Abbreviated or Simple Version:
Property = Property Rights
and our
Expanded Version:
Assets = Liabilities + Owner's Equity

These versions of the accounting equation simply state that assets, also called property, equals what is owed to creditors (liabilities) and the owners (owner's equity), these two elements are also called property rights.

How do Debits and Credits relate to our Accounting Equations ? They're the tools used to keep our equations balanced.

The Balance of the **Left Side** of the Equation (Asset Accounts) will normally have a **DEBIT** Balance and the Balance of the **Right Side** (Liability and Permanent Equity Accounts) will normally have a **CREDIT** Balance.

Left Side	**Right Side**	
Property =	Property Rights	
Assets =	Liabilities +	Owner's Equity
Debit Balances=	**Credit** Balances +	**Credit** Balances
Debit Increases	**Credit Increases**	
Credit Decreases	**Debit Decreases**	

Notice in our table that a debit increases the balances on the left side of the accounting equation (assets) and has the opposite effect and decreases the balances on the right side of the equation (liabilities and owner's equity). Likewise, a credit decreases the balances on the left side of the accounting equation (assets) and has the opposite effect and increases the balances on the right side of the accounting equation (liabilities and owner's equity).

Generally, anything that increases the left side of the equation (property or assets) or decreases the right side of the equation (property rights or liabilities and equity) is considered a debit and anything that increases the right side of the equation (property rights or liabilities and equity) or decreases the left side of the equation (property or assets) is considered a credit.

What we're doing here is relating the types of accounts (assets, liabilities, owner's equity, revenue, expense, and draws) and the terms increases and decreases to the terms debits and credits. The terms debit and credit by themselves **do not mean** an increase or a decrease. The terms have to be associated with the types of accounts in order to gain their meaning.

In other words, whether a debit or credit is an increase or decrease depends on the type of account.

Before we continue our discussion of debits and credits, let's take a look at how the terms are used with the major types of accounts. First we'll discuss assets, liabilities and owner's equity and then revenue, expense, and draws.

They say a picture's worth a thousand words ! Let's revisit our Expanded Accounting Equation Types of Transactions Table used in Lesson 2 and modify it slightly to include our new terms debit and credit. Our following new table illustrates the types of transactions that can occur and the effects of debits and credits on our expanded accounting equation.

Types Of Transactions Table using the Expanded Accounting Equation

Navigation:
Interactive Links are provided in this table in the Examples Of Transactions Column.
- Click on the Underlined Number (1,2,3,etc.) links to navigate to the Transaction Analysis Table Using The Expanded Accounting Equation to see a sample transaction that illustrates the effects of debits and credits on the Expanded Accounting Equation.

The four basic types of transactions and their effects on our expanded accounting equation are represented by the letters a. b. c. and d.

Assets =		**Liabilities + Owner's Equity**		**Examples Of Transactions**
Left Side =		**Right Side**		
(a)	Increase In Assets **Debit**	**(a)**	Increase In Liabilities or Owner's Equity **Credit**	#1 #2 #4 #5 #10
(b)	Decrease In Assets **Credit**	**(b)**	Decrease In Liabilities or Owner's Equity **Debit**	#3 #6 #7
(c)	Increase In One Type of Asset **Debit**			#8
(c)	Decrease In Another Type of Asset **Credit**			#8

		(d)	Increase In One Type of Liability or Owner's Equity **Credit**	#9
		(d)	Decrease In Another Type of Liability or Owner's Equity **Debit**	#9

Take note, this small table illustrates that each transaction is recorded by using a debit and a credit:

- Transaction Type **(a)** Increases an Asset Account on the Left Side using a Debit and Increases a Liability or Owner's Equity Account on the Right Side using a Credit.
- Transaction Type **(b)** Decreases an Asset Account on the Left Side using a Credit and Decreases a Liability or Owner's Equity Account on the Right Side using a Debit.
- Transaction Type **(c)** Increases an Asset Account on the Left Side using a Debit and also Decreases an Asset Account on the Left Side using a Credit.
- Transaction Type **(d)** Increases a Liability or Owner's Equity Account on the Right Side using a Credit and also Decreases a Liability or Owner's Equity Account on the Right Side using a Debit.

The result of this debit and credit "scheme" is that the accounting equation will always be in balance.

Transaction Analysis Using The Simple (Abbreviated) and Expanded Accounting Equations and Debits and Credits

Let's also revisit the tables from Lesson 2 where we analyzed the effects of business transactions on the accounting equation. In that lesson we had a table analyzing transactions using the simple or abbreviated accounting equation and another table that used the expanded accounting equation. This table presents both accounting equations in one table and adds our terms debit and credit to illustrate the effect of debits and credits on our accounting equations.

Navigation:
Interactive Links are provided in this table.
- Click on the Underlined Return To Types Of Transactions Table Link to Return To The Types of Transaction Table.
- Click on the Underlined Dollar Amount Link to navigate to the Equity Table and see the effects of Revenue, Expenses, or Draws.

<table>
<tr><td>Simple (Abbreviated) Accounting Equation</td><td colspan="2">Property =</td><td colspan="4">Property Rights</td></tr>
<tr><td>Expanded Accounting Equation</td><td colspan="2">Assets =</td><td colspan="2">Liabilities +</td><td colspan="2">Owner's Equity</td></tr>
<tr><td>Side of the Accounting Equation</td><td colspan="2">Left Side =</td><td colspan="4">Right Side</td></tr>
<tr><td>Increase/Decrease Columns</td><td>Increase</td><td>Decrease</td><td>Decrease</td><td>Increase</td><td>Decrease</td><td>Increase</td></tr>
<tr><td>Our New Terms In Action</td><td>Debit</td><td>Credit</td><td>Debit</td><td>Credit</td><td>Debit</td><td>Credit</td></tr>
<tr><td colspan="7">Description of Transactions and Their Effects On The Equation</td></tr>
</table>

1. ABC mows a client's yard and receives a check from the customer for $50 for the service provided. Return To Transaction Types Table	50					50
2. ABC purchases $100 worth of office supplies and stores them in their storage room. The office supply store gives them an invoice that allows them to pay for them in 15 days (on account). Return To Transaction Types Table	100			100		
3. ABC places an ad in the local newspaper receives the invoice from the supplier and writes a check for $25 to the newspaper. Return To Transaction Types Table		25			25	
4. ABC purchases five mowers for $10,000 and finances them with a note from the local bank. Return To Transaction Types Table	10,000			10,000		
5. ABC mows another customer's yard and sends the customer a $75 bill (invoice) for the service they performed. They allow their customer ten (10) days to pay them for this service (on account). Return To Transaction Types Table	75					75
6. The owner of ABC needs a little money to pay some personal bills and writes himself a check for $500. Return To Transaction Types Table		500			500	
7. ABC pays the office supply company $100 with a check for the office supplies that they charged (promised to pay). Return To Transaction Types Table		100	100			
8. ABC receives a check from the customer who they billed (invoiced) $75 for services and allowed 10 days to pay. Return To Transaction Types Table	75	75				

9. ABC purchased some mulch for $60 and received an invoice from their supplier who allows them 15 days to pay. The mulch was used on a customer's yard. Return To Transaction Types Table				60	60	
10. ABC bills (prepares an invoice) the customer $80 for the mulch and mowing his yard and receives a check for $80 from the customer. Return To Transaction Types Table	80					80
Totals	$10,380	$700	$100	$10,160	$585	$205

Let's see if you've been fibbing to me about those debits and credits.

Account Type	Debits	Credits
Asset Transactions	$10,380	$700
Liability Transactions	100	10,160
Equity Transactions	585	205
Totals	$11,065	$11,065

By golly those debits and credits do equal each other.

Let's not forget "Ma Capital's (Owner's Equity) Kids" ! We also borrowed another table from Lesson 2 and included the terms debit and credit in the table.

Equity Table

Analysis of the Effects of Debits and Credits and Revenue, Expense, and Draws on Owner's Equity

Navigation:
Interactive Links are included in this table.
• To Return To The Analysis Using The Expanded Accounting Equation Table Click on the Underlined Dollar Amount.

In the previous table, we entered all the transactions that affected Owner's Equity under one heading; namely, Owner's Equity and disregarded whether it was a revenue, expense, or draw item. The following table illustrates where the transactions affecting Owner's Equity would actually be entered.

Instead of recording transactions directly to Owner's Equity ("Ma Capital"), proper bookkeeping actually uses her "Kids" Revenue, Expense, and Draws to record the increases and decreases to "Ma Capital" (Owner's Equity) in order to provide us with the answers to the how and why the owner's claim to the business's property increased or decreased.

This table also illustrates the effects of debits and credits on "Ma Capital's Kids" Revenue, Expense, and Draw. Of course only the sample transactions that affect Owner's Equity (Revenue, Expense, and Draws) have been included.

	"Ma Capital"		"Ma's Kids"		
Proper Recording Actually Uses Revenue, Expense & Draws Instead Of Owner's Equity	Original Recording		Proper Recording Uses		
Transactions	Owner's Equity		Revenue	Expense	Draw
	Decrease	Increase	Revenue Increases Resulting In an Increase to Equity	Expenses Increase Resulting In a Decrease to Equity	Draws Increase Resulting in a Decrease to Equity
	Debit	**Credit**	**Credit**	**Debit**	**Debit**
1. ABC mows a client's yard and receives a check from the customer for $50 for the service provided.		50	50		
3. ABC places an ad in the local newspaper receives the invoice from the supplier and writes a check for $25 to the newspaper.	25			25	
5. ABC mows another customer's yard and sends the customer a $75 bill (invoice) for the service they performed. They allow their customer ten (10) days to pay them for this service (on account).		75	75		
6. The owner of ABC needs a little money to pay some personal bills and writes himself a check for $500.	500				500
9. ABC purchased some mulch for $60 and received an invoice from their supplier who allows them 15 days to pay. The mulch was used on a customer's yard.	60			60	
10. ABC bills (prepares an invoice) the customer $80 for the mulch and mowing his yard and receives a check for $80 from the customer.		80	80		

What should we pick up and learn from these tables and example transactions recorded in the tables ?

Here's What

1. How different types of business transactions affect the Accounting Equation.
2. How it associates increases and decreases and the types of accounts with the terms debits and credit.
3. How each transaction was **recorded twice** illustrating **double entry** bookkeeping.
4. The total amounts for the tables prove the self-balancing nature of the Accounting Equation.
5. How transactions may require increases to both sides of the equation (increase left side **using a debit** and increase right side using a **credit**), decreases to both sides of the equation (decrease left side **using a credit** and decrease right side **using a debit**), or an increase and decreases on the same side of the equation (increase and decrease the left side **or** increase and decrease the right side of the equation **using a debit and a credit**), but the equation must always balance.
6. The Equity Table illustrates that, while transactions that affect Owner's Equity could be entered using only one column, additional useful information is obtained by breaking Owner's Equity into its component parts (kids) using the revenue, expense, and draws categories to record the transactions.
    1. That revenues increase owner's equity while expenses and draws decrease owner's equity.
    2. It illustrates that we **could use only** the Main Account Types - **Assets**, **Liabilities**, and **Owner's Equity (Capital)** contained in our Basic Expanded Accounting Equation (Assets = Liabilities + Owner's Equity) to record our transactions and not use "Ma Capital's Kids" **Revenue**, **Expense**, and **Draws**.

        The drawback of just using "Ma Capital" (the Owner's Equity Account) is that the Owner's Equity (Capital) Account would require a great deal of analysis and time in order to determine the income or loss for a period and the reasons for this income or loss.

From here on out, transactions will be recorded using "Ma's Kids" revenue, expense, and draws.

Can you guess what we're going to discuss next ? How about the **Fully Expanded** Version of our Accounting Equation and debits and credits.

Fully Expanded Version of The Accounting Equation and Debits and Credits

In Lesson 2, we discussed, developed, and explained the Fully Expanded Accounting Equation. I also said that we would be revisiting this topic in this lesson. Well, I'm a man of my word.

If you recall,

since

(1) Property = Assets and
(2) Property Rights (Claims to the Property) = Liabilities + Equity,

the simple or abbreviated accounting equation Property = Property Rights expanded or restated became

Assets = Liabilities + Owner's Equity.

We also concentrated on the **Owner's Equity (Capital)** portion of the equation and discussed how the balance of Owner's Equity ("Ma Capital") is affected by her "kids" Revenue, Expense, Investment, and Draws.

Let's review these effects one more time:

- Owner Investments (Kid Investment) increase Owner's Equity
- Revenues (Kid Revenue) increase Owner's Equity
- Expenses (Kid Expense) decrease Owner's Equity
- Owner's Draws (Kid Draws) decrease Owner's Equity

Using the above information we arrived at the following equation:

Current Owner's Equity = Beginning Owner's Equity + Owner's Investments + Revenues - Expenses - Draws

Our new owner's equity equation illustrated the relationships and effects investments, revenue, expense, and draws have on **Owner's Equity**.

Taking this one step further, we arrived at our **Fully Expanded Accounting Equation** which included all the components that make up and affect Owner's Equity.

Our Expanded Accounting Equation Assets = Liabilities + Owner's Equity expanded or restated became our

Fully Expanded Accounting Equation

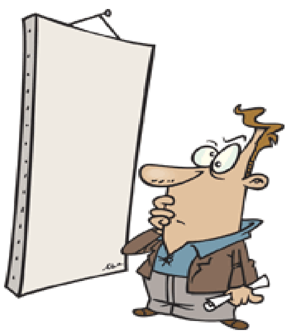
Assets = Liabilities + Beginning Owner's Equity + Additional Owner Investments + Revenues - Expenses - Draws.

In the Expanded Version of the Accounting Equation, "Ma Capitals's Kids" are hiding behind her skirt. There there; you just don't see them. The fully expanded version unhides them and shows you their affects on Owner's Equity ("Ma Capital").

We'll use the following table as an aid to see how all the pieces of the game called bookkeeping fit together.

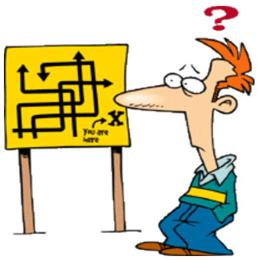
Normal Debit Balances	Normal Credit Balances	Normal Debit **and** Credit Balances	Profit or Loss
Assets =	Liabilities +	**Beginning** Owner's Equity (Normal **Credit** Balance)	

		+ Additional Owner Investments (Normal **Credit** Balance)	
		+ Revenue (Normal **Credit** Balance)	**+ Revenue**
		- Expenses (Normal **Debit** Balance)	**- Expense**
			= **Profit or Loss**
		- Draws (Normal **Debit** Balance)	
		= **Ending** Owner's Equity (Normal **Credit** Balance)	



Just from looking at the above table and not even knowing anything about bookkeeping, what should you be able to tell me ?

- Assets = Liabilities + **Ending** Owner's Equity
- Revenues - Expenses = Profit or Loss
- **Beginning** Owner's Equity + Owner's Contributions + Revenue - Expense - Draws = **Ending** Owner's Equity
- Asset Accounts normally have Debit Balances.
- Liability Accounts normally have Credit Balances.
- Owner's Equity (Capital) Account normally has a Credit Balance.
- Two of Ma's Kids, Expense and Draws, normally have a Debit Balance.
- Two of Ma's Kids, Revenue and Investments normally have a Credit Balance.
- Revenues increase Owner's Equity (Capital) because they're added to Owner's Equity.
- Expenses decrease Owner's Equity (Capital) because they're subtracted from Owner's Equity.
- Draws decrease Owner's Equity (Capital) because they're subtracted from Owner's Equity.
- Besides the Owner's Original Investment in his/her business, at times, the owner may have to contribute or invest additional assets which increase Owner's Equity.
  Note: Additional owner investments are normally added directly (credited) to the Owner's Capital Account Balance.
- Owner Draws are not used to figure the profit or loss of the business.
  Note: The owner's draws could be equal, less than, or more than the profit / loss of the business.
- Additional Owner Contributions, Revenues, Expenses, and Draws eventually are all merged together and become a part of the Ending Owner's Equity Balance. If you've heard the phrase **Closing The Books**, believe it or not, this is all that's basically involved in Closing The Books.



Determining What To Debit and Credit or as William Shakespeare might have said "To Debit or Credit that is the question."

All this stuff that you've told me is great; but, how do I determine what to debit and credit when recording transactions ? And here I am thinking that you won't ask.

Account Definition

An **Account** is a separate record for each type of asset, liability, equity, revenue, and expense used to show the beginning balance and to record the increases and decreases for a period and the resulting ending balance at the end of a period.

You should be aware that **All Accounts**:

- Can Be Debited and Credited
- Have an Increase Side (Column) and a Decrease Side (Column)
- Have a Debit Side (Column) and a Credit Side (Column)
  Debit Side is the Left Side (Left Column)
  Credit Side is the Right Side (Right Column)
- Have a Type and are classified as an Asset, Liability, Equity, Revenue, Expense, or Draw
- Are Either a Balance Sheet or Income Statement Account
- Have a Normal Balance Amount that is normally a Debit Balance or a Credit Balance

The **Normal Balance** is the debit or credit balance that an account is expected to have.
The normal balance is also the side of the account that increases the balance of the account. Since the **increase side** of assets, draws, and expense accounts is the left (debit) side these accounts normally have a debit balance. Likewise, since the **increase side** of liabilities, revenue, and owner's equity (capital) accounts is the right (credit) side these accounts normally have a credit balance. In other words, since debits increase asset, draw, and expense accounts, they normally have a debit (left side balance). Conversely, because credits increase liability, equity, and revenue accounts, they normally have a credit (right side) balance.

Comment: An account can occasionally end up with a balance that is not its normal balance. A good example would be a business "strapped" for cash that ends up with a credit balance in its cash account by writing out checks for more funds than they have on deposit in the bank. This credit balance signifies that the account is overdrawn, and instead of being classified as an asset, which it normally is, is now a temporary liability (amount owed to bank).

Do you remember this Equation ?

I mentioned this equation at the end of Lesson 2 ? The Debit and Credit Equation is just a variation (rearranged version) of the Fully Expanded Accounting Equation. Some simple Algebra was used to rearrange the major types of accounts.

Debit and Credit Equation

Assets + Draws + Expenses = Liabilities + Owner's Equity + Revenue
Normal Debit Balance Accounts = Normal Credit Balance Accounts

In this rearranged form of our fully expanded accounting equation, all the types of accounts that have a normal debit balance are listed on the left side of the equal sign and all the types of accounts that have a normal credit balance are listed on the right side of the equal sign.

Based on our Debit and Credit Equation we can state the following:

Normal Account Balance

Debit Balances

- Asset - Normally a Debit Balance
- Draws - Normally a Debit Balance
- Expense - Normally a Debit Balance

Credit Balances

- Liabilities - Normally a Credit Balance
- Owner's Equity (Capital) - Normally a Credit Balance
- Revenue - Normally a Credit Balance

Just knowing the normal balances for the types of accounts makes it much easier to determine when to use debits and credits. Now, let's dig in and learn some rules or methods.

Methods for Determining What To Debit and Credit.
While they all require some degree of memorization, some are less taxing on the brain cells than others.

(1) Memorize the definitions for debits and credits.

Debit - An entry (amount) entered on the left side (column) of a journal or general ledger account that increases an asset, draw or an expense or an entry that decreases a liability, owner's equity (capital) or revenue.

Credit - An entry (amount) entered on the right side (column) of a journal or general ledger account that increases a liability, owner's equity (capital) or revenue, or an entry that decreases an asset, draw, or an expense.

This is actually no different than memorizing the other terms that were presented in Lesson 1.

(2) Convert the Definitions To Detail Debit and Credit Rules and Memorize The Rules

At least I've supplied a Table and a T-Account presentation of the Accounts to help in this endeavor.

Our Summarized Debit and Credit Rules Table

Account Type	**Debit**	**Credit**	**Normal Account Balance**
Assets Liabilities	Increase Decrease	Decrease Increase	Debit Balance Credit Balance

Owner's Equity	Decrease	Increase	Credit Balance
Revenue	Decrease	Increase	Credit Balance
Expense	Increase	Decrease	Debit Balance
Draw	Increase	Decrease	Debit Balance

A debit increases an asset while a credit decreases an asset.
A debit decreases a liability while a credit increases a liability.
A debit decreases owner's equity while a credit increases owner's equity.
A debit decreases revenue while a credit increases revenue.
A debit increases an expense while a credit decreases an expense.
A debit increases a draw while a credit decreases a draw.

If you look at the expense and draw categories, there appears to be a contradiction. In the Equity Table presented earlier in this lesson, the description for a debit to an expense says it **decreases equity** which is exactly what an expense does. It reduces the owner's claim to the property (assets). What might be a "little" confusing is that our summary of how debits and credits affect categories says that a debit to an expense is an increase. This is also true. The debit increases the **amount** of the expense which in turn **decreases** owner's equity.

Let's clarify with a simple example. Assume my business has advertising expenses of $2,000.00 as of yesterday. I write a check today for a another $1,000.00 for advertising. I debit advertising for $1000.00 which **increases** the **amount** spent on advertising to a total of $3,000.00 and has the additional effect of decreasing my equity by an additional $1,000.00.

The same logic applies to draws.

Our Rules Illustrated With T-Accounts

Asset, Drawing,
and Expense Accounts
Normal Balance Debit Amount

Account Name

Increase Debit	**Decrease** Credit
Left Side or Debit Side of Account	Right Side or Credit Side of Account

Liability, Owner's Equity (Capital)
and Revenue Accounts
Normal Balance Credit Amount

Account Name

Decrease Debit	**Increase** Credit
Left Side or Debit Side of Account	Right Side or Credit Side of Account

What the heck is this ? T-Accounts are used as a tool to illustrate business transactions, debits and credits, double entry bookkeeping, and the purpose of accounts. It is called this because it has the form of the letter T. On the top of the horizontal bar there is the account title (name). Increases and Decreases are placed on the side of the vertical bar depending on whether the account type is an asset, liability or equity account. The left side of the T-account is called Debit, and the right side is called Credit. These terms are often abbreviated

as Dr. and Cr.

We accountant types say an account has been debited when an amount is placed on the left side of an account and credited when the amount is placed on the right side. The difference between the debit and the credit side of an account (total increases less total decreases) is called the account balance.

(3) Simplify and Summarize the Detail Debit and Credit Rules
This develops rules based on our earlier discussion of normal account balances and our **Debit and Credit Equation** that was derived from our Fully Expanded Accounting Equation and was presented earlier.
Assets + Draws + Expenses = Liabilities + Owner's Equity + Revenue
Normal Debit Balance Accounts = Normal Credit Balance Accounts

Using this knowledge, we can state our simplified debit and credit rules as:

All Accounts that Normally Have a Debit Balance (Left Side of Our Debit and Credit Equation) are Increased with a Debit and Decreased with a Credit.

- Assets
- Draws
- Expenses

All Accounts that Normally have a Credit Balance (Right Side of Our Debit and Credit Equation) are Increased with a Credit and Decreased with a Debit.

- Liabilities
- Owner's Equity (Capital)
- Revenue

(4) Simplify Even More
If you're anything like me, you like it as simple as possible. As others have done using acronyms, I've developed my own method for determining when to use debits and credits that builds on and simplifies the prior method.

Bean Counter's Simple Debit and Credit Rule

- My method begins by identifying the major types of accounts which of course are Assets, Liabilities, Owner's Equity, Revenue, Expense, and Draws.
- Next, we determine how many major types of accounts are listed. Our listing includes 6 (six).
- Assuming that we wanted to group these 6 (six) accounts into 2 (two) equal groups, how many account types would be included in each group ? If my math is correct 6/2 (six divided by two) is equal to 3 (three).
- Also assuming that we wanted to alphabetize our account groups, our listing would appear as Assets, Draws, Expenses, Liabilities, Owner's Equity, and Revenue.
- Now, dividing this listing into our 2 (two) groups with three account types in each we have:

    - Group 1
      Assets, Draws, and Expenses
      This group is the types of accounts that normally have a debit balance.
    - Group 2
      Liabilities, Owner's Equity, and Revenue
      This group is the types of accounts that normally have a credit balance.

- Now, let's just use the first letter of each group to represent the type of account.
  - Group 1
    A (Asset), **D** (Draw), and **E** (Expense)
  - Group 2
    L(liability), **O** (Owner's Equity), and **R** (Revenue)

Now we have our ingredients for **Bean Counter's Simple Debit and Credit Rule**.

All **A, D, and E** (Asset, Draw, and Expense) types of accounts, which normally have a debit balance, are increased with a debit and decreased with a credit.
All **L,O, and R** (Liability, Owner's Equity, and Revenue) type accounts, which normally have a credit balance, are increased with a credit and decreased with a debit.

All you have to remember is that:

1. Group 1 types of accounts (A, D, and E) all normally have a debit balance and their balances are increased by using a debit.
2. Group 2 types of accounts (L, O, and R) all normally have a credit balance and their balances are increased by using a credit.
3. Just use the other term (reverse) to record the decrease for each group.
   In other words, if a debit increases the balance of a type of account in the group, then a credit is going to decrease the balance of the type of account in the group. Likewise, if a credit increases the balance of a type of account in the group, then a debit is going to decrease the balance of the type of account in the group.

(5) When all else fails, there's my Debit Credit Cheat Sheet.
Who says you can't have a cheat sheet unless of course you're taking an exam ?

All You Need To Know About Debits and Credits Summarized In One Sentence:

Enter an amount in the **Normal Balance Side** of an Account to **Increase the Balance** of an Account and in the **Opposite Side** of an Account to **Decrease the Balance** of an Account.

Additional Clarification:
Since **A**ssets, **D**raw, and **E**xpense Accounts **normally have a Debit Balance**, in order to Increase the Balance of an **A**sset, **D**raw, or **E**xpense Account enter the amount in the Debit or Left Side Column and in order to Decrease the Balance enter the amount in the Credit or Right Side Column.

Likewise, since **L**iabilities, **O**wner's Equity (Capital), and **R**evenue Accounts **normally have a Credit Balance** in order to Increase the Balance of a **L**iability, **O**wner's Equity, or **R**evenue Account the amount would be entered in the Credit or Right Side Column and the amount would be entered in the Debit or Left Side column to Decrease the Account's Balance.

How To Use and Apply The Debit and Credit Rules:

(1) Determine the types of accounts the transactions affect-asset, liability, revenue, or expense account.
(2) Determine if the transaction increases or decreases the account's balance.
(3) Apply the debit and credit rules based on the types of accounts and whether the balance of the account will increase or decrease.

So you know !

There are various symbols that are used to indicate Debits and Credits and whether an account's balance is a Debit or a Credit.

Ways and symbols you might run across are:

- Dr for Debit and Cr for Credit
- + (Plus Sign) for Debit and - (Minus Sign) for Credit
- No Bracket for Debit and < > (Brackets) for Credit
- No Parentheses for Debit and ( ) (Parentheses) for Credit

Symbol	Indicates a Debit	Indicates a Credit
Dr / Cr	Dr	Cr
+ / -	+	-
No Bracket / Bracket < >		< >
No Parentheses / Parentheses ( )		( )

Note: The plus (+) and minus (sign) are often used by accounting and bookkeeping programs to indicate debits and credits. Don't get confused and think that the plus sign means an increase or that the minus sign means a decrease. They **do not**. In this case, they are simply symbols that mean either a debit or a credit.

You're all probably familiar with the saying "Can't See The Forest For The Trees". So, before we move on, let's step back out of the trees (detail) so we can see the forest (big picture) regarding debits and credits.

Debits and Credits are actually based on some **Simple Concepts**.
So let's end this lesson with a quick summary.

What You Should Know About Debits and Credits

- An Account has an Increase Side (Column) and a Decrease Side (Column).
- The Left Side (Column) of an Account is the Debit Side (Column) and the Right Side (Column) of an Account is the Credit Side (Column).
- Debits are simply entries in the left column of an account and Credits are simply entries in the right column of an account.
- When you **record an entry in the Left Side (Column)** of an Account this is called **Debiting an Account**.
- When you **record an entry in the Right Side (Column)** of an Account this is called **Crediting an Account**.
- Debits do not always represent increases to an account's balance. Nor, do they always represent decreases to an account's balance.
- Likewise, Credits do not always represent increases to an account's balance. Nor, do they always represent decreases to an account's balance.
- Whether a Debit or Credit to an Account is an Increase or Decrease **depends on the Type of Account** - Asset - Liability - Owner's Equity - Revenue - Expense - Draw.

- A credit to a particular type of account always does the opposite that a debit does. In other words - if a debit increases an account's balance a credit decreases the account's balance or vice versa - if a debit decreases an account's balance a credit increases the account's balance.
- All Accounts have a **Normal Balance** which is either a Debit Balance or a Credit Balance.
  Assets, Draws, and Expenses all have **Normal Debit Balances**.
  Liabilities, Owner's Equity (Capital), and Revenue all have **Normal Credit Balances**.
- When using the double entry bookkeeping system, the sum of the debits must equal the sum of the credits for a transaction to be in balance.
- Every transaction must have a dollar entry entered on the left side of an account(s) and a dollar entry entered on the right side of an account(s).
- When calculating an Account's Balance, Debits are always added together and Credits are always added together; but a Debit and Credit are subtracted from each other.
- Just as you have a left and right side of the accounting equation, you also have a left and right side of an account.
- Every transaction involves at least one debit and one equal offsetting credit. If a transaction has more than one debit and/or credit, the total of the debits must equal the total of the credits. This is called a compound entry.
- The term Debit should not be associated with good or bad. Likewise the term Credit should not be associated with good or bad.
- If we properly use debits and credits to record and summarize our bookkeeping records, our Debits will always equal our Credits and provide some assurance that our records are accurate.

Unfortunately, the only way to tell if you mastered debits and credits is to put you under the light and grill you.

Let's see what you know.

Debit/Credit Skills Test I
Debit/Credit Skills Test II

Note:Skill Tests use JavaScript which is enabled on most computers.

Debit/Credit Quiz

Before we end our discussion of debits and credits, let's do a little pretending and wander back in history. You, myself, and the guy given credit for developing the double entry bookkeeping system are going to take a look at how the system may have evolved.

Logic of Debits and Credits

Debits and Credits are crucial concepts to understanding bookkeeping. I hope you've been paying attention and haven't let this lesson go in one ear and out the other.

Up until now, we've been using the Major Types of Accounts (Assets, Liabilities, Owner's Equity, Revenue, Expenses, and Draws) in our discussions and analyses. In our remaining lessons, we'll be using the detail accounts that make up the major types of accounts such as Cash, Accounts Receivable, Accounts Payable, etc. in our discussions and analyses.

Don't worry if you haven't fully grasped the concept of debits and credits-yet. Notice I said yet. The next Lesson is going to expand on and provide additional explanations and

exercises to help you fully understand this concept. Keep in mind the ole sayings **"Out Of Confusion Comes Knowledge"** and **"Practice Makes Perfect"**.

<--BACK NEXT-->

Introduction	Lesson 1	Lesson 2	Lesson 3	Lesson 4	Lesson 5	Lesson 6	Lesson 7

Bean Counter

So, you want to learn Bookkeeping!

by Bean Counter's Dave Marshall

Lesson 4

Recording Business Transactions

Introduction	Lesson 1	Lesson 2	Lesson 3	Lesson 4	Lesson 5	Lesson 6	Lesson 7

Bean Counter

If you thought you we're going to be able to sit back and relax on the beach, I'm sorry to disappoint you. I'm only one currently entitled to this luxury (I already know bookkeeping but you're getting there).

Let's reflect a little on what we've covered so far.
In the Introduction we discussed the types of business organizations, types of business activities, users of financial information, bookkeeping systems, accounting rules, and the cash and accrual basis of accounting.
Lesson 1 introduced you to some of the terminology and definitions used in the accounting and bookkeeping language.
Lesson 2 explained Property & Property Rights, the Accounting Equation, double entry bookkeeping, and how business transactions affect the equation.
Lesson 3 introduced and explained Debits and Credits and how they affect the Accounting Equation and are u to record business transactions.

If you feel you need a refresher on any of these topics now would be a good time to review any prior lessons before continuing on.

Introduction	Lesson 1	Lesson 2	Lesson 3

Under the light again to see what stuck to your many brain cells. I'm a firm believer in "show me", so let's see what you know at this time.

Basic Accounting Review Quiz

Even if you did well on the review quiz and feel fairly comfortable with the material that has already been presented, a quick review of some of the prior material will be beneficial for understanding the material presented in this lesson.

Type Of Accounts

In prior lessons, we mainly used "The Big Three" (Assets, Liabilities, and Owner's Equity) and "Ma Capital's (Owners Equity) Kids" (Revenue, Expense, Investment, and Draws) as our "accounts" to learn how business transactions affect account balances.

These seven **"big"** type of accounts were defined in Lesson 1 as follows:

Assets
Formal Definition:The properties used in the operation or investing activities of a business.
Informal Definition:All the good stuff a business has (anything with value). The goodies.

Liability
Formal Definition:Claims by creditors to the property (assets) of a business until they are paid.
Informal Definition:Other's claims to the business's stuff. Amounts the business owes to others.

Owner's Equity also called Owner's Capital
Formal Definition:The owner's rights to the property (assets) of the business; also called proprietorship and n worth.
Informal Definition:What the business owes the owner. The good stuff left for the owner assuming all liabilitie (amounts owed) have been paid.

"Ma Capital's (Owner's Equity) Four Kids"

- **Revenue**
Formal Definition:The gross increase in owner's equity resulting from the operations and other activities of th business.
Informal Definition:Amounts a business earns by selling services and products. Amounts billed to customers f services and/or products.
- **Expense**
Formal Definition:Decrease in owner's equity resulting from the cost of goods, fixed assets, and services and supplies consumed in the operations of a business.
Informal Definition:The costs of doing business. The stuff we used and had to pay for or charge to run our business.
- **Draws**
Formal Definition: Decrease in owner's equity resulting from withdrawals made by the owner.
Informal definition: Amounts the owner withdraws from his business for living and personal expenses.
- **Owner's Investments**
Formal Definition: Increase in owner's equity (capital) resulting from additional investments of cash and/or ot property made by the owner.

Informal definition: Additional amounts, either cash or other property, that the owner puts in his business.

In the real bookkeeping world, we want to know the detail types of assets, liabilities, equity (capital), revenu
expenses, and draws.

In Lesson 1 we discussed some of the detail **types** of assets, liabilities, equity, revenue, and expenses. Can Y
name a few ? I'll help you.
Examples of Assets-Cash, Accounts Receivable, Notes Receivable, Buildings, and Equipment
Examples Of Liabilities-Accounts Payable, Notes Payable, and Mortgage Payable
Examples Of Revenue-Product Sales, Rental Income, and Service Revenue
Examples Of Expenses-Employee Wages, Building Rental, Telephone, Utilities, Advertising, Office Supplies

Rules for Debits and Credits that we will use in this lesson were just covered in Lesson 3. If you've slept since
then, the following procedure is what you use in order to use and apply the Debit and Credit Rules when
recording bookkeeping transactions.

All You Need To Know About Debits and Credits Summarized In One Sentence:

Enter an amount in the **Normal Balance Side** of an Account to **Increase the Balance**
an Account and in the **Opposite Side** of an Account to **Decrease the Balance** of an
Account.

Additional Clarification:
Since **A**ssets, **D**raw, and **E**xpense Accounts **normally have a Debit Balance**, in order to Increase the Balan
an **A**sset, **D**raw, or **E**xpense Account enter the amount in the Debit or Left Side Column and in order to Decre
the Balance enter the amount in the Credit or Right Side Column.

Likewise, since **L**iabilities, **O**wner's Equity (Capital), and **R**evenue Accounts **normally have a Credit Balance**
order to Increase the Balance of a **L**iability, **O**wner's Equity, or **R**evenue Account the amount would be entere
the Credit or Right Side Column and the amount would be entered in the Debit or Left Side column to Decrea
the Account's Balance.

How To Use and Apply The Debit and Credit Rules:

(1) Determine the type of account(s) the transactions affect-asset, liability, revenue, or expense account.
(2) Determine if the transaction increases or decreases the account's balance.
(3) Apply the debit and credit rules based on the type of account and whether the balance of the account will
increase or decrease.

Let's revisit another definition and term that was defined in Lesson 1 and discussed in Lesson 3.
Account-a separate record for each type of asset, liability, equity, revenue, and expense used to show the
beginning balance and to record the increases and decreases for a period and the resulting ending balance at
end of a period.

Any of these or any others that our business needs or wants to track have their own separate and individual
account. What officially do we call this detail listing of accounts that we set up for our business ? Simply a **Ch**
Of Accounts.

In this lesson and future lessons we are going to stray away from analyzing and recording transactions using **"Big Accounts"** and start using the **detail** accounts to record and analyze our business transactions.

Let's take a step in this direction by setting up a simple chart of accounts for ABC Mowing.

Simple Chart Of Accounts For ABC Mowing

Assets
Account Name:Cash
Description:Currency and checks and balance in bank

Account Name:Accounts Receivable
Description:Amounts due from customer's for services rendered

Account Name:Inventory-Office Supplies
Description:On hand supplies of such items as copier & computer paper, pens, pencils and other office supplies

Account Name:Mowing Equipment
Description:Mowers purchased

Liabilities
Account Name:Accounts Payable
Description:Amounts owed suppliers for business purchases and expenses

Account Name:Note Payable-Bank
Description:Mortgages and loans owed to bank

Equity
Account Name:Owner's Capital
Description:Amounts invested by owner and earned operations

Account Name:Owner's Draws
Description:Amounts withdrawn by owner for perso expenses

Revenue
Account Name:Mowing Revenues
Description:Earnings from mowing yards

Expenses
Account Name:Advertising Expense
Description:Expenditures for TV, radio, newspaper, and other promotions.

Account Name:Mulch Expense
Description:Expenditures for mulch used for yard w

In order to record the information in our accounts, we also need to be familiar with the source documents tha provide us with the necessary information for recording our transactions.

Source Documents

The original sources of information that provide documentation (proof) that a transaction has occurred are sa invoices (tickets), invoices from suppliers, contracts, checks written and checks received , promissory notes, various other types of business documents. These documents provide us with the information needed to reco our financial transactions in our bookkeeping records.

Typical Types Of Business Transactions and the Debits and Credits and Accounts Used To Record Them

In a typical business transaction we get something and we give up something.

- **Sale-Sell goods and/or services**
  - Cash Sale-customer pays at the time of sale
    The business **gets** cash or a check from their customer and **gives** up a product or service to th

customer.
Accounts Used:
Debit: Cash
Credit: Sales
    - On Account Sale-business allows the customer time to pay
      The business **gets** a promise to pay from their customer and **gives** up a product or service to their customer.
      Accounts Used:
      Debit: Accounts Receivable
      Credit: Sales
- **Purchase goods and/or services**
    - Cash Purchase-business pays the supplier at the time of purchase
      The business **gets** a product or service from their supplier and **gives** up cash or a check to the supplier.
      Accounts Used:
      Debit: Expense or Inventory Account
      Credit: Cash
    - On Account Purchase-supplier allows the business time to pay
      The business **gets** a product or service from a supplier and **gives** up a promise to pay to their supplier.
      Accounts Used:
      Debit: Expense or Inventory Account
      Credit: Accounts Payable
- **Pay Supplier Charge Purchases** -pay suppliers for products and/or services that we promised to pa for later (charge).
  The business **gets** the amount of their promise to pay the supplier reduced and **gives** up cash or a check.
  Accounts Used:
  Debit: Accounts Payable
  Credit: Cash
- **Receive Customer Charge Payments** -receive payments from a customer that promised to pay us later (charge sale).
  The business **gets** cash or a check from their customer and **gives** up (reduces the amount of) their customer's promise to pay.
  Accounts Used:
  Debit: Cash
  Credit: Accounts Receivable
- **Borrow Money** (Loans) The business **gets** cash or equipment and **gives** up a promise to pay.
  Accounts Used:
  Debit: Cash or Equipment
  Credit: Note Payable
- **Repay a Loan**
  The business **gets** the amount of their promise to pay reduced and **gives** up cash or a check.
  Accounts Used:
  Debit: Note Payable
  Credit: Cash
- **Draw**
  The business **gets** the owner's claim to the business assets reduced and **gives** up cash or a check.
  Accounts Used:
  Debit: Owner's Draw
  Credit: Cash
- **Payroll** (not covered in this tutorial)

The business **gets** services from their employees and **gives** up a check.
Accounts Used:
Debit: Salary & Wages Expense
Credit: Cash

T-Accounts

We're going to record our transactions using our ole buddy the **T-Account**.

Notice that Assets, Draws, and Expense Type of Accounts are **increased** using the Left Side (Column) of the account (**debited**) and **decreased** using the Right Side (Column) of the account (**credited**). The reverse is t for the Liability, Equity, and Revenue Type of Accounts. These Type Of Accounts are **increased** using the Rig Side (Column) of the account (**credited**) and **decreased** using the Left Side (Column) of the account (**debited**).

Asset Accounts
Account Name

Increase Debit	Decrease Credit
Left Side or Debit Side of Account	Right Side or Credit Side of Account

Liability Accounts
Account Name

Decrease Debit	Increase Credit
Left Side or Debit Side of Account	Right Side or Credit Side of Account

Equity (Capital) Accounts
Account Name

Decrease Debit	Increase Credit
Left Side or Debit Side of Account	Right Side or Credit Side of Account

Revenue Accounts
Account Name

Decrease Debit	Increase Credit
Left Side or Debit Side of Account	Right Side or Credit Side of Account

Expense Accounts
Account Name

Increase Debit	Decrease Credit
Left Side or Debit Side of Account	Right Side or Credit Side of Account

Draw Accounts
Account Name

Increase Debit	Decrease Credit
Left Side or Debit Side of Account	Right Side or Credit Side of Account

Now, I think we should be ready to revisit our ABC Mowing Company and record the transactions presented i prior lessons in our detailed accounts (T-Accounts). We are going to assume that ABC has beginning balance already recorded in their accounts. These balances are as of December 1, xxxx.

Note: If these balances were as of the beginning of the year the nominal or temporary accounts - revenues, expenses, and draws would all have zero balances.

Lastly, we are going to thoroughly review each transaction for December xxxx and show you the hows and w to properly recording each transaction and present the steps for properly analyzing and recording a transacti

ABC's Beginning Account Balances as of December 1, xxxx

Assets		Liabilities		Equity	
Cash	$5,500 Dr	Accounts Payable	$2,000 Cr	Owner's Capital	$7,500 Cr
Accounts Receivable	$1,600 Dr			Mowing Revenue	$1,000 Cr
Mowing Equipment	$2,500 Dr			Advertising Expense	$200 Dr
Inventory-Office Supplies	$ 0 Dr			Mulch Expense	$100 Dr
				Owner Draws	$600 Dr

Notice I used the symbols **Dr** and **Cr** to abbreviate the Debit and Credit balances in the table of ABC's beginn balances. While this is a common method of representing debits and credits, other symbols that we discusse Lesson 3 are also used.

You'd better check me out to see if our books balance before we start recording ABC's transactions. We're go to perform two checks that relate to what we've been learning in prior lessons.

The first check is to see if our Accounting Equation balances and the second to make sure that the debit balances equal the credit balances.

Equation Check Calculations

Total Assets = Cash + Accounts Receivable + Mowing Equipment
Total Assets = 5,500 + 1,600 + 2,500
Total Assets = 9,600

Total Liabilities is easy because there is only one account (Accounts Payable) with a balance of 2,000.
Total Liabilities = 2,000

Total Equity = Owner's Capital + Revenues - Expenses - Draws
Since we have more than one expense let's summarize them before we use them in our equation.
Total Expenses = Mulch Expense + Advertising
Total Expenses = 100 + 200
Total Expenses = 300

Total Equity = Owner's Capital + Revenues - Expenses - Draws
Total Equity = 7,500 + 1000 - 300- 600
Total Equity = 7,600

Substituting our totals into the Accounting Equation we find that our equation balances.

Assets =	Liabilities +	Owner's Equity
9,600	2,000	7,600

Our second check is to see if our debit account balances equal our credit account balances.

Let's total our Debit Balances

Cash	5,500
Accounts Receivable	1,600
Mowing Equipment	2,500
Advertising Expense	200
Mulch Expense	100
Owner's Draw	600
Total Debits	10,500

Now we'll total our Credit Balances

Accounts Payable	2,000
Owner's Capital	7,500
Mowing Revenue	1,000
Total Credits	10,500

It looks like we passed muster again.

ABC Transactions

Let's revisit that mowing business once again. This time we're going to record our transactions using our **detail type of accounts** such as Cash, Accounts Receivable, Mow Equipment, Mowing Revenues, etc. to record our transactions.

Navigation:
Interactive Links are provided in this table.
• Click on the Underlined Transaction Number Link (1,2,3,etc.) to go to the Detailed Information Pertaining to the Transaction.

1. ABC mows a client's yard and receives a check from the customer for $50 for the service provided.
2. ABC purchases $100 worth of office supplies and stores them in their storage room. The office supply stor
gives them an invoice that allows them to pay for them in 15 days (on account).
3. ABC places an ad in the local newspaper receives the invoice from the supplier and writes a check for $25
the newspaper.
4. ABC purchases five mowers for $10,000 and finances them with a note from the local bank.
5. ABC mows another customer's yard and sends the customer a $75 bill (invoice) for the service they
performed. They allow their customer ten (10) days to pay them for this service (on account).
6. The owner of ABC needs a little money to pay some personal bills and writes himself a check for $500.
7. ABC pays the office supply company $100 with a check for the office supplies that they charged (promised
pay).
8. ABC receives a check from the customer who they billed (invoiced) $75 for services and allowed 10 days t
pay.
9. ABC purchased some mulch for $60 and received an invoice from their supplier who allows them 15 days t
pay. The mulch was used on a customer's yard.
10. ABC bills (prepares an invoice) the customer $80 for the mulch and mowing his yard and receives a chec
for $80 from the customer.

We will discuss each transaction and "post" the entry to the appropriate account (T-Account). Keep in mind t
each entry will have a debit and a credit.

In your actual formal General Ledger, which will be discussed and explained in Lesson 5, each account has a
amount column for debits (left side or first column) and an amount column for credits (right side or second
column).

Detail Transaction Information

Navigation:
Interactive Links are included for each transaction that return you to the List Of Transactions.

- Click On the Underlined Return To Transaction Link to Return To The List Of Transactions.

For each transaction for ABC Mowing, we will identify the Source Document, Type Of Transaction, Accounts Affected, and determine and explain the Debits and Credits needed to properly record and post to our T-Accounts.

Entry 1
1. ABC mows a client's yard and receives a check from the customer for $50 for the service provided.

Source Document:Customer's Check
Type Of Transaction:Cash Sale
Accounts Affected:Cash   Sales
Debits and Credits:
Increase (Left Side) Cash: Debit
Increase (Right Side) Mowing Revenue (Sales): Credit

Explanation Using Our Debit/Credit Rules:The asset cash is increased. An increase is recorded by entering th amount in the normal balance side of an account. The normal balance side of cash, which is an asset, is the l (debit) side of the account so we increase cash by entering the amount in the left side as a debit. Mowing Revenue (Equity) is also increased. Again, an increase is recorded by entering the amount in the normal bala side of an account. The normal balance side of a revenue account is the right (credit) side of the account so w increase mowing revenue (sales) by entering the amount in the right side as a credit.

Asset Account
Cash

Increase Debit		Decrease Credit	
Beg Bal.	5,500		
(1)	50		

Revenue (Equity) Account
Mowing Revenues

Decrease Debit		Increase Credit	
		Beg Bal.	1,000
		(1)	50

Return To Transaction Listing

Entry 2
2. ABC purchases $100 worth of office supplies and stores them in their storage room. The office supply stor gives them an invoice that allows them to pay for them in 15 days (on account).

Source Document:Supplier's Invoice
Type Of Transaction:On Account Purchase
Accounts Affected:Inventory-Office Supplies   Accounts Payable
Debits and Credits:
Increase (Left Side) Inventory-Office Supplies: Debit
Increase (Right Side) Accounts Payable: Credit

Explanation Using Our Debit/Credit Rules:The asset inventory-office supplies is increased. An increase is recorded by entering the amount in the normal balance side of an account. The normal balance side of inventory-office supplies, which is an asset, is the left (debit) side of the account so we increase inventory-of supplies by entering the amount in the left side as a debit. The liability accounts payable is also increased. Again, we record an increase by entering the amount in the normal balance side of an account. The normal balance side of accounts payable, which is a liability, is the right (credit) side of the account so we increase accounts payable by entering the amount in the right side as a credit.

Asset Account
Inventory-Office Supplies

Increase Debit		Decrease Credit	
(2)	100		

Liability Account
Accounts Payable

Decrease Debit		Increase Credit	
		Beg Bal.	2,000
		(2)	100

Return To Transaction Listing

Entry 3
3. ABC places an ad in the local newspaper receives the invoice from the supplier and writes a check for $25 the newspaper.

Source Document:Supplier's Invoice and Company Check
Type Of Transaction:Cash Purchase
Accounts Affected:Advertising Expense (Equity)   Cash
Debits and Credits:
Increase (Left Side) Advertising Expense (Decrease Equity): Debit
Decrease (Right Side) Cash: Credit

Explanation Using Our Debit/Credit Rules:The expense advertising expense is increased. An increase is recor by entering the amount in the normal balance side of an account. The normal balance side of advertising expense, which is an expense account, is the left (debit) side so we increase advertising expense by entering the amount in the left side as a debit. The asset cash is decreased. We record a decrease by entering the amount in the opposite side of the normal balance side of an account. The normal balance side of cash, which an asset, is the left (debit) side so we decrease cash by entering the amount in the opposite side which is the right (credit) side of the account as a credit.

Some additional clarification might be useful in order to clarify why an expense is recorded as an increase wi debit. The actual amount of the advertising expense has increased. The business now has spent more for advertising. More expenses are not what a business or an individual wants. Increased personal expenses red our personal equity and likewise increased business expenses reduce the owner's equity of a business. Since increase in an expense reduces equity it is recorded as an increase using a debit.

Asset Account
Cash

Increase Debit		Decrease Credit	
Beg Bal.	5,500	(3)	25
(1)	50		

Expense (Equity) Account
Advertising Expense

Increase Debit		Decrease Credit	
Beg Bal.	200		
(3)	25		

Return To Transaction Listing

Entry 4
4. ABC purchases five mowers for $10,000 and finances them with a note from the local bank.

Source Document:Bank Note
Type Of Transaction:Borrow Money
Accounts Affected:Mowing Equipment   Note Payable-Bank
Debits and Credits:
Increase (Left Side) Mowing Equipment: Debit
Increase (Right Side) Note Payable-Bank: Credit

Explanation Using Our Debit/Credit Rules:The asset mowing equipment is increased. An increase is recorded entering the amount in the normal balance side of an account. The normal balance side of mowing equipmen which is an asset account, is the left (debit) side so we increase mowing equipment by entering the amount the left side as a debit. The liability note payable-bank is also increased. Again, an increase is recorded by entering the amount in the normal balance side of an account. The normal balance side of note payable-bank which is a liability account, is the right (credit) side , so we increase note payable-bank by entering the amou in the right side as a credit.

Asset Account

Liability Account

Mowing Equipment

Increase Debit		Decrease Credit	
Beg Bal.	2,500		
(4)	10,000		

Note Payable-Bank

Decrease Debit		Increase Credit	
		(4)	10,000

Return To Transaction Listing

Entry 5
5. ABC mows another customer's yard and sends the customer a $75 bill (invoice) for the service they performed. They allow their customer ten (10) days to pay them for this service (on account).

Source Document:Sales Invoice
Type Of Transaction:On Account Sale
Accounts Affected:Accounts Receivable   Mowing Revenue (Sales)
Debits and Credits:
Increase (Left Side) Accounts Receivable: Debit
Increase (Right Side) Mowing Revenue (Sales): Credit

Explanation Using Our Debit/Credit Rules:The asset accounts receivable is increased. An increase is recorded entering the amount in the normal balance side of an account. The normal balance side of accounts receivabl which is an asset, is the left (debit) side of the account so we increase accounts receivable by entering the amount in the left side as a debit. Mowing Revenue (Equity) is also increased. Again, an increase is recorded entering the amount in the normal balance side of an account. The normal balance side of a revenue account the right (credit) side of the account so we increase mowing revenue (sales) by entering the amount in the r side as a credit.

Asset Account
Accounts Receivable

Increase Debit		Decrease Credit	
Beg Bal.	1,600		
(5)	75		

Revenue (Equity) Account
Mowing Revenues

Decrease Debit		Increase Credit	
		Beg Bal.	1,000
		(1)	50
		(5)	75

Return To Transaction Listing

Entry 6
6. The owner of ABC needs a little money to pay some personal bills and writes himself a check for $500.

Source Document:Check
Type Of Transaction:Draw
Accounts Affected:Cash   Draw
Debits and Credits:
Increase (left Side)Owner's Draw (Decrease Equity): Debit
Decrease (Right Side) Cash: Credit

Explanation Using Our Debit/Credit Rules:The draw account owner's draw is increased. An increase is recorde by entering the amount in the normal balance side of an account. The normal balance side of owner's draw, which is a draw account, is the left (debit) side so we increase owner's draw by entering the amount in the le side as a debit. The asset cash is decreased. We record a decrease by entering the amount in the opposite si of the normal balance side of an account. The normal balance side of cash, which is an asset, is the left (debi side so we decrease cash by entering the amount in the opposite side which is the right (credit) side of the account as a credit.

Asset Account
Cash

Increase Debit		Decrease Credit	
Beg Bal.	5,500	(3)	25
(1)	50	(6)	500

Draw (Equity) Account
Owner's Draw

Increase Debit		Decrease Credit	
Beg Bal.	600		
(6)	500		

Return To Transaction Listing

Entry 7
7. ABC pays the office supply company $100 with a check for the office supplies that they charged (promisec pay).

Source Document:Check
Type Of Transaction:Pay Supplier Charge Purchases
Accounts Affected:Cash   Accounts Payable
Debits and Credits:
Decrease (Left Side) Accounts Payable: Debit
Decrease (Right Side) Cash: Credit

Explanation Using Our Debit/Credit Rules: The asset cash is decreased. We record a decrease by entering the amount in the opposite side of the normal balance side of an account. The normal balance side of cash, whicl an asset, is the left (debit) side so we decrease cash by entering the amount in the opposite side which is the right (credit) side of the account as a credit. The liability account accounts payable is also decreased. We rec a decrease by entering the amount in the opposite side of the normal balance side of an account. The norma balance side of accounts payable, which is a liability, is the right (credit) side so we decrease accounts payab by entering the amount in the opposite side which is the left (debit) side of the account as a debit.

Asset Account
Cash

Increase Debit		Decrease Credit	
Beg Bal.	5,500	(3)	25
(1)	50	(6)	500
		(7)	100

Liability Account
Accounts Payable

Decrease Debit		Increase Credit	
(7)	100	Beg Bal.	2,000
		(2)	100

Return To Transaction Listing

Entry 8

8. ABC receives a check from the customer who they billed (invoiced) $75 for services and allowed 10 days t pay.

Source Document:Customer Check
Type Of Transaction:Receive Customer Charge Payments
Accounts Affected:Cash Accounts Receivable
Debits and Credits:
Increase (Left Side) Cash: Debit
Decrease (Right Side) Accounts Receivable: Credit

Explanation Using Our Debit/Credit Rules:The asset cash is increased. An increase is recorded by entering th amount in the normal balance side of an account. The normal balance side of cash, which is an asset, is the l (debit) side of the account so we increase cash by entering the amount in the left side as a debit. Another as account, accounts receivable decreased. We record a decrease by entering the amount in the opposite side o the normal balance side of an account. The normal balance side of accounts receivable, which is an asset, is left (debit) side so we decrease accounts receivable by entering the amount in the opposite side which is the right (credit) side of the account as a credit. We actually "swapped" one asset accounts receivable for anothe asset cash.

Asset Account
Cash

Increase Debit		Decrease Credit	
Beg Bal.	5,500	(3)	25
(1)	50	(6)	500
(8)	75	(7)	100

Asset Account
Accounts Receivable

Increase Debit		Decrease Credit	
Beg Bal.	1,600	(8)	75
(5)	75		

Return To Transaction Listing

Entry 9
9. ABC purchased some mulch for $60 and received an invoice from their supplier who allows them 15 days t pay. The mulch was used on a customer's yard.

Source Document:Supplier's Invoice
Type Of Transaction: Purchase on Account
Accounts Affected:Mulch Expense Accounts Payable
Debits and Credits:
Increase (Left Side) Mulch Expense (Decrease Equity): Debit
Increase (Right Side) Accounts Payable: Credit

Explanation Using Our Debit/Credit Rules:The expense mulch expense is increased. An increase is recorded b entering the amount in the normal balance side of an account. The normal balance side of mulch expense, w is an expense account, is the left (debit) side so we increase mulch expense by entering the amount in the le side as a debit. The amount owed to a supplier increased. The liability accounts payable is increased. An increase is recorded by entering the amount in the normal balance side of an account. The normal balance si of accounts payable, which is a liability, is the right (credit) side of the account so we increase accounts paya by entering the amount in the right side as a credit.

Liability Account
Accounts Payable

Decrease Debit		Increase Credit	
(7)	100	Beg Bal.	2,000
		(2)	100
		(9)	60

Expense (Equity) Account
Mulch Expense

Increase Debit		Decrease Credit	
Beg Bal.	100		
(9)	60		

[Return To Transaction Listing]

Entry 10
10. ABC bills (prepares an invoice) the customer $80 for the mulch and mowing his yard and receives a chec
for $80 from the customer.

Source Document:Sales Invoice and Customer Check
Type Of Transaction:Cash Sale
Accounts Affected:Cash   Mowing Revenue (Sales)
Debits and Credits:
Increase (Left Side) Cash: Debit
Increase (Right Side) Mowing Revenue (Equity): Credit

Explanation Using Our Debit/Credit Rules: The asset cash is increased. An increase is recorded by entering th
amount in the normal balance side of an account. The normal balance side of cash, which is an asset, is the l
(debit) side of the account so we increase cash by entering the amount in the left side as a debit. Mowing
Revenue (Equity) is also increased. Again, an increase is recorded by entering the amount in the normal bala
side of an account. The normal balance side of a revenue account is the right (credit) side of the account so w
increase mowing revenue (sales) by entering the amount in the right side as a credit.

Asset Account
Cash

Increase Debit		Decrease Credit	
Beg Bal.	5,500	(3)	25
(1)	50	(6)	500
(8)	75	(7)	100
(10)	80		

Revenue (Equity) Account
Mowing Revenue

Decrease Debit		Increase Credit	
		Beg Bal.	1,000
		(1)	50
		(5)	75
		(10)	80

[Return To Transaction Listing]

ABC's Calculated Ending Account Balances After Posting
Me, being the nice guy that I am, calculated the ending account balances for you.

Assets		Liabilities		Equity	
Cash	$5,080 Dr	Accounts Payable	$2,060 Cr	Owner's Capital	$7,500 Cr

Accounts Receivable	$1,600 Dr	Note Payable-Bank	$10,000 Cr	Mowing Revenue	$1,205 Cr
Mowing Equipment	$12,500 Dr			Advertising Expense	$225 Dr
Inventory-Office Supplies	$100 Dr			Mulch Expense	$160 Dr
				Owner Draws	$1,100 Dr

Let's perform our checks on our ending balances after posting.

The first check is to see if our Accounting Equation balances and the second to make sure that the debit balances equal the credit balances.

Equation Check Calculations

Total Assets = Cash + Accounts Receivable + Mowing Equipment +Office Supplies
Total Assets = 5,080 + 1,600 + 12,500 + 100
Total Assets = 19,280

Total Liabilities = Accounts Payable + Notes Payable
Total Liabilities = 2,060 + 10,000
Total Liabilities = 12,060

Total Equity = Owner's Capital + Revenues - Expenses - Draws
Since we have more than one expense let's summarize them before we use them in our equation.
Total Expenses = Mulch Expense + Advertising
Total Expenses = 160 + 225
Total Expenses = 385

Total Equity = Owner's Capital + Revenues - Expenses - Draws
Total Equity = 7,500 + 1205 - 385- 1100
Total Equity = 7,220

Substituting our totals into the Accounting Equation we find that our equation balances.

Assets =	Liabilities +	Owner's Equity
19,280	12,060	7,220

Our second check is to see if our debit account balances equal our credit account balances.

Let's Total Our Debit Balances

Cash	5,080
Accounts Receivable	1,600
Mowing Equipment	12,500
Inventory-Office Supplies	100
Advertising Expense	225
Mulch Expense	160
Owner's Draw	1100

Total Debits	20,765

Now we'll total our Credit Balances

Accounts Payable	2,060
Note Payable-Bank	10,000
Owner's Capital	7,500
Mowing Revenue	1,205
Total Credits	20,765

Looks like everything is still in balance after we posted our transactions.

Assets = Liabilities + Owner's Equity
and our Debit Balance Accounts = our Credit Balance Accounts.

Oh no, more debit and credit testing ! Yeah, you're back under the grilling lights once again
At least it's not a padded cell.

Look at the good side. At least by now you should be very familiar with our mowing guy's transactions.

Debit/Credit Skills Test III

Note:Skill Tests use JavaScript which is enabled on most computers.

That wasn't too bad was it ? Get a grip on yourself. We still have three more lessons to complete. Let's tackle the next lesson that covers the General Ledger and Journals.

So, you want to learn Bookkeeping!

by Bean Counter's Dave Marshall

Lesson 5

The General Ledger and Journals

General Ledger

In Lesson 4 we used T-Accounts to record the transactions for ABC, the lawn mowing guys. What you didn't know at the time is that we were actually recording transactions in General Ledger Accounts. A General Ledger is just a formal set of T-Accounts. Each account that we want to track and keep up with has a separate page or pages maintained in a record book called the General Ledger. The book is organized into major sections just like the Accounting Equation that we studied in previous lessons. Do you have any idea what these sections might be ? Come on this question is not that hard. The general ledger's major sections are Assets, Liabilities, Owner's Equity, Revenues, Expenses, and Draws.

For each item (account) in our General Ledger, we record the increases and decreases for a period (usually a month) and calculate its ending balance. The ending balance of the account is easily determined by adding the increases and subtracting the decreases from the account's beginning period balance.

Ending Account Balance = Beginning Balance + Increases - Decreases

If you noticed in my above equation I used the terms increases and decreases. If you also recall in our discussion about debits and credits in Lesson 3, I tried to stress the fact that when applied to bookkeeping these terms need to be **associated with the types of accounts**.

We also should know by now that the type of accounts have a normal balance that is either a debit or credit balance. So actually the above equation is stated in two ways. The equation is stated one way for debit balance accounts, and another way for credit balance accounts.

Using our bookkeeping terms debits and credits, we come up with the following equations:

Debit Balance Accounts Equation

- Ending Account Balance for Normal Debit Balance Accounts = Beginning Balance + Debits(Increases) - Credits(Decreases)

Credit Balance Accounts Equation

- Ending Account Balance for Normal Credit Balance Accounts = Beginning Balance + Credits(Increases) - Debits(Decreases)

Simply stated a General Ledger is just a book containing the **summarized** financial transactions and balances of the **accounts** for all of a business's assets, liabilities, equity, revenue, and expense accounts.

One other record that goes hand in hand with the general ledger and that we've touched on before and used in the prior lesson is **The Chart Of Accounts**. Remember The Chart Of Accounts is simply a listing of all the accounts in the general ledger that contains the account's name, a brief description of the account, and usually an account number assigned to aid in recording and tracking transactions.

It's chief purpose is to serve as an aid (reference) for looking up accounts and their associated account numbers.

For this lesson, we expanded our chart of accounts by adding account numbers and grouped the numbers into ranges that represent the major type of accounts.

Chart Of Accounts For ABC Mowing
Note: The charts of accounts used in this tutorial were purposely kept simple and used to illustrate what the chart of accounts is and how it's used. For those of you that are curious, I've provided a detailed list of the accounts you might encounter in the "real" world.

- Balance Sheet Accounts
- Income Statement Accounts

You might also want to check out my tutorial **So, you want to learn Bookkeeping! - Chart Of Accounts**.

Normally a numbering system is set up with a range of numbers for assets, liabilities, equity, revenue, and expense accounts. ABC Assets have a range from 100-199 ;Liabilities a range from 200-299; Equity a range from 300-399, Revenues a range from 400-499, and Expenses a range from 500-599.

Assets (100-199)
Account Name:Cash
Account Number:100
Description:Currency and checks and balance in bank

Account Name:Accounts Receivable
Account Number:110
Description:Amounts due from customer's for services rendered

Account Name:Inventory-Office Supplies
Account Number:115
Description:On hand supplies of such items as copier & computer paper, pens, pencils and other office supplies

Account Name:Mowing Equipment
Account Number:150

Equity (300-399)
Account Name:Owner's Capital
Account Number:300
Description:Amounts invested by owner and earned by operations

Account Name:Owner's Draws
Account Number:310
Description:Amounts withdrawn by owner for personal expenses

Revenue (400-499)
Account Name:Mowing Revenues
Account Number:400
Description:Earnings from mowing yards

Expenses (500-699)
Account Name:Advertising Expense
Account Number:510

Description:Mowers purchased

Description:Expenditures for TV, radio, newspaper, and other promotions.

Account Name:Mulch Expense
Account Number:520
Description:Expenditures for mulch used for yard work

Liabilities (200-299)
Account Name:Accounts Payable
Account Number:200
Description:Amounts owed suppliers for business purchases and expenses

Account Name:Note Payable-Bank
Account Number:210
Description:Mortgages and loans owed to bank

Of course most businesses have many more than our eleven accounts we used for our sample ABC business. Can you think of some other accounts that we might need and want ? How about telephone, utilities, professional fees (that's me), salaries & wages, equipment rental, building rental, maintenance & repairs, contract labor, office equipment just to name a few.

Back To The General Ledger

What Information does a **General Ledger** Page contain ?

- Name of Account and Account Number
- Date of Posting
- Description-additional notes about the entry if needed
- Posting Reference-journals name (abbreviation) , page, and entry reference
- Amounts of the debits or credits transferred
- Current Balance of the Account

Sample of a General Ledger Page

The Posting Reference **GJ-1-1** refers to:
GJ-General Journal
1-Page 1
1-Entry Number 1

Click on the posting reference to see the journal entry

Account Name:Cash			Account Number:100		
Date	Description	Post Ref.	Debit Amount	Credit Amount	Balance
Jan 1, xxxx	Beg Bal				5000
Jan 5, xxxx		GJ-1-1		1000	4000
Jan 8, xxxx		GJ-1-2	200		4200
Jan 10, xxxx		GJ-1-3		400	3800

Return To General Ledger Check

Notice that the account has an amount column for debits (left side or first column) and an amount column for credits (right side or second column).

General Journal

Journals are preliminary records where business transactions are first entered into the accounting system. The journal is commonly referred to as the book of original entry. Specialized Journals-are journals used to initially record special types of transactions such as sales, cash disbursements, and cash receipts in their own journal.

The end result of double entry bookkeeping is having an up to date , in balance, and properly posted Ledger. In our prior lessons we recorded all our debits and credits (transactions) directly in the General Ledger. This would work for a small business that had very few transactions but would become unwieldy for most businesses with any volume of activity. By its very definition the General Ledger is supposed to be a **summary record** of a business's financial transactions.

It logically follows that since we only want summary amounts in our Ledger we need to record our detail entries some place else first. What record(s) do we use to do this ? Your right ! Journals are our preliminary records. All our transactions are first entered in a preliminary record called a journal or book of original entry. This process is called journalizing. After our business transactions have been entered in our journal(s), they are then periodically (usually monthly) summarized and totaled and then transferred (posted) to the General Ledger as summary entries.

What type of information is included in the **Journal Record** ?

- Entry Number
- Date of each transaction
- Names and/or the account numbers of the accounts to be debited or credited
- Amounts of the debits and credits
- Posting Reference-Account Number in the General Ledger
- Explanation or description of the entry

The journals contain all the chronological (by date) information necessary to record debit and credit amounts in the accounts of the General Ledger.

Sample of A General Journal Page

General Journal			Page 1		
Entry No	Date	Account Name	Post Ref.	Debit	Credit
GJ-1-1	Jan 5, xxxx	Supplies	502	1000	
		Cash	100		1000

Record Supplies Expense					
GJ-1-2	Jan 8, xxxx	Cash	100	200	
		Sales	300		200
Record Cash Sale					
GJ-1-3	Jan 10, xxxx	Advertising Expense	500	400	
		Cash	100		400
Record Advertising Expense					
GJ-1-4	Jan 20, xxxx	Utilities		650	
		Cash			650
Record Utilities Expense					

Click On the posting reference (account number) to see the entry posted in the sample General Ledger (only for posting reference Account No:100 Cash)

Do you notice anything odd about any of our entries in our General Journal ? Look at entry number 4 (GJ-1-4). It doesn't have a posting reference. Why not ? The answer is simple. Entry Number 4 has not yet been posted to the General Ledger. This is our way of keeping up with what entries have and have not been posted to the General Ledger.

Check me out to see if I'm telling the truth General Ledger Check

Remember ABC ? Yeah, it's the mowing guys.

Navigation:
Interactive Links are included in the following Beginning Balances Table.
- Click on the Underlined Dollar Amounts (Links) to see the Beginning Amounts recorded in the appropriate General Ledger Accounts.

ABC's Beginning Account Balances as of December 1, xxxx

Assets		Liabilities		Equity	
Cash	\$5,500	Accounts Payable	(\$2,000)	Owner's Capital	(\$7,500)
Accounts Receivable	\$1,600			Mowing Revenue	(\$1,000)
Mowing Equipment	\$2,500			Advertising Expense	\$200
				Mulch Expense	\$100
				Owner Draws	\$600

Note: Credit balances are indicated by using parentheses ( ).

ABC Transactions for December xxxx

Oh Shucks, those mowing guys again ! Notice that this time the check numbers, invoice numbers, and dates were added to the transaction descriptions.

Navigation:
Interactive Links are included in the following transaction list.

- Click on the Journal Entry Link to be taken to the Formal Journal Entry recorded for the transaction in the General Journal. The transaction will be the first one displayed in the Journal.

1. December 2, xxxx ABC mows a client's yard and receives a check # 484 from the customer for $50 for the service provided.
Journal Entry 1
2. December 4, xxxx ABC purchases $100 worth of office supplies and stores them in their storage room. The office supply store gives them an invoice # 983 that allows them to pay for them in 15 days (on account).
Journal Entry 2
3. December 8, xxxx ABC places an ad in the local newspaper receives the invoice from the supplier # 555 and writes a check # 900 for $25 to the newspaper.
Journal Entry 3
4. December 10, xxxx ABC purchases five mowers for $10,000 and finances them with a note from the local bank.
Journal Entry 4
5. December 15, xxxx ABC mows another customer's yard and sends their customer a $75 bill (invoice # 1000) for the service they performed. They allow their customer ten (10) days to pay them for this service (on account).
Journal Entry 5
6. December 20, xxxx the owner of ABC needs a little money to pay some personal bills and writes himself a check # 901 for $500.
Journal Entry 6
7. December 22, xxxx ABC pays the office supply company $100 with a check # 902 for the office supplies that they charged (promised to pay invoice # 983).
Journal Entry 7
8. December 27, xxxx ABC receives a check # 55 from the customer who they billed (invoiced # 1000) $75 for services and allowed 10 days to pay.
Journal Entry 8
9. December 29, xxxx ABC purchased some mulch for $60 and received an invoice # 777 from their supplier with terms of 15 days. The mulch was used on a customer's yard.
Journal Entry 9
10. December 31, xxxx ABC bills (prepares an invoice # 1001) the customer $80 for the mulch and mowing his yard and receives a check for $80 # 555 from the customer.
Journal Entry 10

General Journal

The transactions for ABC are presented below in a formal General Journal. Review the entries and if you have any questions go back to Lesson 4 for detailed discussions for each of the transactions.

The reference numbers refer to General Journal, Entry Number, and Page Number. **GJ-1-1** means GJ (General Journal), Page 1, and Entry 1. The Posting Reference (Post Ref.) is the General Ledger Account Number taken from our Simple Chart Of Accounts.

Navigation:
Interactive Links are included in our following General Journal.

- Click on the Underlined Entry Number (GJ-1-1, etc.) to Return or be Taken To the Transaction Listing.
- Click on the Underlined Account Name Link or the Underlined Posting Reference (Account Number) Link to see the entry posted (transferred) from the General Journal to The General Ledger Account.

General Journal			Page 1		
Entry Number	Date	Account Name	Post Ref.	Debit	Credit
GJ-1-1	Dec 2, xxxx	Cash	100	50	
		Mowing Revenue	400		50
Record customer check # 484 and revenue from mowing job.					
GJ-1-2	Dec 4, xxxx	Inventory-Office Supplies	115	100	
		Accounts Payable	200		100
Record invoice # 983 for office supplies purchased on account.					
GJ-1-3	Dec 8, xxxx	Advertising Expense	510	25	
		Cash	100		25
Record check # 900 for advertising services					
GJ-1-4	Dec 10, xxxx	Mowing Equipment	150	10000	
		Note Payable-Bank	210		10000
Record purchase of mowing equipment financed by bank note.					
GJ-1-5	Dec 15, xxxx	Accounts Receivable	110	75	
		Mowing Revenue	400		75
Invoice (# 1000) customer on account for revenue earned from mowing yard.					
GJ-1-6	Dec 20, xxxx	Owner's Draw	310	500	
		Cash	100		500
Record owner's draw check # 901.					
GJ-1-7	Dec 22, xxxx	Accounts Payable	200	100	
		Cash	100		100
Record check # 902 paid to supplier for office supplies charged on account (invoice # 983).					
GJ-1-8	Dec 27, xxxx	Cash	100	75	
		Accounts Receivable	110		75
Record customer's check # 55 received from customer on account.					
GJ-1-9	Dec 29, xxxx	Mulch Expense	520	60	
		Accounts Payable	200		60
Record mulch purchase/expense (invoice # 777) with credit terms.					
GJ-1-10	Dec 31, xxxx	Cash	100	80	
		Mowing Revenue	400		80

Record check # 80 received from customer paying our invoice #1001 for mowing services.

ABC's General Ledger

Navigation:
Interactive Links are included in the following General Ledger Accounts.

- Click on the Underlined Posting Reference Link (GJ-1-1,etc.) in the General Ledger Account to Return or Be Taken to the Related Journal Entry.
- Click on the Underlined Beginning Balance (Beg Bal.) Link to see where we got the Beginning Balances for our Accounts.
- Click on the Underlined Balance Link to see the entry entered in the Trial Balance.

ABC's General Ledger with the transactions posted (transferred) from the General Journal follows.

Assets

Account Name:Cash			Account Number:100		
Date	Description	Post Ref.	Debit	Credit	Balance
Dec 1	Beg Bal.				5500
Dec 2		GJ-1-1	50		5550
Dec 8		GJ-1-3		25	5525
Dec 20		GJ-1-6		500	5025
Dec 22		GJ-1-7		100	4925
Dec 27		GJ-1-8	75		5000
Dec 31		GJ-1-10	80		5080

Account Name:Accounts Receivable			Account Number:110		
Date	Description	Post Ref.	Debit	Credit	Balance
Dec 1	Beg Bal.				1600
Dec 15		GJ-1-5	75		1675
Dec 27		GJ-1-8		75	1600

Account Name:Inventory-Office Supplies			Account Number:115		
Date	Description	Post Ref.	Debit	Credit	Balance
Dec 1	Beg Bal.				0
Dec 4		GJ-1-2	100		100

Account Name:Mowing Equipment			Account Number:150		
Date	Description	Post Ref.	Debit	Credit	Balance
Dec 1	Beg Bal.				2500
Dec 10		GJ-1-4	10000		12500

Liabilities

Account Name:Accounts Payable				Account Number:200	
Date	Description	Post Ref.	Debit	Credit	Balance
Dec 1	Beg Bal.				(2000)
Dec 4		GJ-1-2		100	(2100)
Dec 22		GJ-1-7	100		(2000)
Dec 29		GJ-1-9		60	(2060)

Account Name:Note Payable-Bank				Account Number:210	
Date	Description	Post Ref.	Debit	Credit	Balance
Dec 1	Beg Bal.				0
Dec 10		GJ-1-4		10000	(10000)

Equity

Account Name:Owner's Capital				Account Number:300	
Date	Description	Post Ref.	Debit	Credit	Balance
Dec 1	Beg Bal.				(7500)

Account Name:Owner's Draws				Account Number:310	
Date	Description	Post Ref.	Debit	Credit	Balance
Dec 1	Beg Bal.				600
Dec 20		GJ-1-6	500		1100

Revenue & Expense

Account Name:Mowing Revenue				Account Number:400	
Date	Description	Post Ref.	Debit	Credit	Balance
Dec 1	Beg Bal.				(1000)
Dec 2		GJ-1-1		50	(1050)
Dec 15		GJ-1-5		75	(1125)
Dec 31		GJ-1-10		80	(1205)

Account Name:Advertising Expense				Account Number:510	
Date	Description	Post Ref.	Debit	Credit	Balance
Dec 1	Beg Bal.				200
Dec 8		GJ-1-3	25		225

Account Name:Mulch Expense	Account Number:520

Date	Description	Post Ref.	Debit	Credit	Balance
Dec 1	Beg Bal.				100
Dec 29		GJ-1-9	60		160

Trial Balance

We used a Trial Balance at the end of Lesson 4 to check our postings. I just didn't tell you at the time. Let's review the formal definition. A Trial Balance is a listing of all the accounts appearing in the general ledger with the dollar amount of the debit or credit balance of each. It is used to make sure the books are "in balance" - total debits and credits are equal.

A trial balance is just a worksheet that bookkeeper's and accountants prepare from the General Ledger to check that the books (General Ledger) are in balance (Debit Account Balances = Credit Account Balances).

Let's prepare our trial balance for ABC at the end of December.

Navigation:
Interactive Links are included in our Trial Balance.
- Click on the Underlined Account Name Link to go to the Ending Balance in the General Ledger Accounts.

Account	**Debit Balances**	**Credit Balances**
Asset Accounts		
Cash	5080	
Accounts Receivable	1600	
Inventory-Office Supplies	100	
Mowing Equipment	12500	
Liability Accounts		
Accounts Payable		2060
Note Payable-Bank		10000
Equity Accounts		
Owner's Capital		7500
Owner's Draws	1100	

Revenue Accounts		
Mowing Revenue		1205
Expense Accounts		
Mulch Expense	160	
Advertising Expense	225	
Totals	20765	20765

Sure enough our debit balances equal our credit balances. How did we determine what account balances had a debit balance and what account balances had a credit balance ? It was easy because we used the parentheses ( ) to denote that an account balance was a credit. Therefore, all the balances that **are not** enclosed in parentheses make up our **Debit Balance Accounts** and all the balances **enclosed in parentheses** make up our **Credit Balance Accounts**.

So you know !

We covered this earlier; but, it's worth repeating. In this lesson we used parentheses ( ) to indicate credits. Remember that this is just one of the methods used for indicating debits and credits and whether an account's balance is a Debit or a Credit.

Ways and symbols you might run across are:

- Dr for Debit and Cr for Credit
- + (Plus Sign) for Debit and - (Minus Sign) for Credit
- No Bracket for Debit and < > (Brackets) for Credit
- No Parentheses for Debit and ( ) (Parentheses) for Credit

Symbol	Indicates a Debit	Indicates a Credit
Dr / Cr	Dr	Cr
+ / -	+	-
No Bracket / Bracket < >		< >
No Parentheses / Parentheses ( )		( )

Note: The plus (+) and minus (sign) are often used by accounting and bookkeeping programs to indicate debits and credits. Don't get confused and think that the plus sign means an increase or that the minus sign means a decrease. They **do not**. In this case, they are simply symbols that mean either a debit or a credit.

Normal Balances for the Types of Accounts

Just to keep you on your toes - do you recall what type of accounts normally have a debit or credit balance ?

- Assets, Expenses, and Draws normally have Debit Balances.
- Liabilities, Owner's Capital, and Revenue accounts normally have Credit Balances.

Need proof ?
Refer back to our preceding Trial Balance for ABC. The Trial Balance has a column for Debit Balance Accounts and a column for Credit Balance Accounts.

Sure enough, our Assets, Owner's Draws, and Expense Type of Accounts are listed in the Debit Balance Column. Likewise, our Liability, Owner's Capital, and Revenue Type of Accounts are listed in the Credit Balance Column.

How do you initially determine that an Account has a Debit or Credit Balance ? This is simply a matter of determining if the Account has more Debit Amounts Posted or More Credit Amounts Posted. If More Debits Than Credits have been posted to the Account, the Account will have a **Debit Balance**. Likewise, if More Credits Than Debits have been posted to the Account, the Account will have a **Credit Balance**.

You have now been introduced to some of bookkeeping and accounting's formal records, namely the General Ledger and General Journal. You could get by with just these two records, but if your business like most has many transactions instead of the few that ABC had you'd be spending a heck of a lot of time recording and posting. What's the solution to streamlining the recording and posting processes.

Remember when I introduced Journals in this lesson where I briefly mentioned Special Journals ? Well, they are the solution.

Some **Special Journals** a business will normally have are:

- Cash Receipts Journal
- Cash Disbursements Journal (Check Register)
- Payroll Journal
- Sales Journal
- Purchase Journal
- General Journal

All these journals are designed to record special types of business transactions and post the totals accumulated in these journals to the General Ledger periodically (usually once a month).

Instead of using just one journal to record all our business transactions we use many. Although this tutorial is not going to discuss the Special Journals I wanted to make you aware of them and the purpose they serve.

If you want to learn more about Special Journals, my **So, you want to learn Bookkeeping - Special Journals** tutorial covers this topic.

Before we move on to Lesson 6, since they say that a picture's worth a thousand words, let's use a picture to illustrate the flow of information (business transactions) into our bookkeeping records. You're right Financial Statements haven't been discussed, but guess what's coming in Lesson 6 ?

Source Documents provides the initial data about business transactions.
Journals use the information from the source documents to create a chronological listing of all business transactions and detailed information about each transaction.
General Ledger

uses the information transferred from the journal(s) to summarize the data into individual accounts.
Trial Balance uses the information from the General Ledger to summarize the data to use for preparing the Financial Statements.
Financial Statements uses the summarized data contained in the Trial Balance to prepare the business's financial reports .

Where's that darn light and quiz ? This reminds me of an ole American commercial about hamburgers with an ole lady driving up to a fast food window and after being served asking "Where's the beef ?". I do think you deserve a break; but, before we go get back under the light. Just a few questions and then you're free to take a break.

Basic Bookkeeping-General Ledger and Journals

We've been gradually climbing the ladder of bookkeeping knowledge. We're not at the top but we're getting there. Hang in there only a few more lessons left.

<--BACK **NEXT-->**

Introduction	Lesson 1	Lesson 2	Lesson 3	Lesson 4	Lesson 5	Lesson 6	Lesson 7

Bean Counter

So, you want to learn Bookkeeping!

by Bean Counter's Dave Marshall

Lesson 6

Financial Statements

The objective of this lesson is not so much a how to do it; but, to inform, introduce, and make you aware of the basic financial statements.

Let's start this lesson by reviewing a few definitions.

Financial Statements are summary accounting reports prepared periodically to inform the owner, creditors, and other interested parties as to the financial condition and operating results of the business. The four basic financial statements or reports are:

Balance Sheet-The financial statement which shows the amount and nature of business assets, liabilities, and owner's equity as of a specific point in time. It is also known as a Statement Of Financial Position or a Statement Of Financial Condition.

Income Statement-The financial statement that summarizes revenues and expenses for a specific period of time, usually a month or a year. This statement is also called a Profit and Loss Statement or an Operating Statement.

Capital Statement-The financial report that summarizes all the changes in owner's equity that occurred during a specific period.

Statement of Changes in Financial Position-The financial statement that reports the sources and uses of cash or working capital for a specific period of time, normally a year.

The Balance Sheet

A Balance Sheet is simply a picture of a business at a specific point in time, usually the end of the month or year. By analyzing and reviewing this financial statement the current financial "health" of a business can be determined. The balance sheet is derived from our accounting equation and is a **formal representation of our equation**

Assets = Liabilities + Owner's Equity.

If you recall, in an earlier lesson we learned that this equation is also called the Balance Sheet Equation.

The categories and format of the Balance Sheet are based on what are called Generally Accepted Accounting Principles (GAAP). These principles are the rules established so that every business prepares their financial statements the same way.

Assets
Formal Definition:The properties used in the operation or investment activities of a business.

Informal Definition:All the good stuff a business has (anything with value). The goodies.

Additional Explanation: The good stuff includes tangible and intangible stuff. Tangible stuff you can physical see and touch such as vehicles, equipment and buildings. Intangible stuff is like pieces of paper (sales invoices) representing loans to your customers where they promise to pay you later for your services or product. Examples of assets that many individuals have are cars, houses, boats, furniture, TV's, and appliances. Some examples of business type assets are cash, accounts receivable, notes receivable, inventory, land, and equipment.

Assets are listed based on how quickly they can be converted into cash which is called liquidity. In other words, they're ranked. The asset most easily converted into cash is listed first followed by the next easiest and so on. Of course since cash is already cash it's the first asset listed.

Liabilities
Formal Definition:Claims by creditors to the property (assets) of a business until they are paid.

Informal Definition:Other's claims to the business's stuff. Amounts the business owes to others.

Additional Explanation: Usually one of a business's biggest liabilities (hopefully they are not past due) is to suppliers where they have bought goods and services and charged them. This is similar to us going out and buying a TV and charging it on our credit card. Our credit card bill is a liability. Another good personal example is a home mortgage. Very few people actually own their own home. The bank has a claim against the home which is called a mortgage. This mortgage is another example of a personal liability. Some examples of business liabilities are accounts payable, notes payable, and mortgages payable.

Liabilities are listed in the order of how soon they have to be paid. In other words, the liabilities that need to be paid first are also listed first.

Owner's Equity (Capital)
Formal Definition:The owner's rights to the property (assets) of the business; also called proprietorship and net worth.

Informal Definition:What the business owes the owner. The good stuff left for the owner assuming all

liabilities (amounts owed) have been paid.

Additional Explanation:Owner's Equity represents the owner's claim to the good stuff (assets). Most people are familiar with the term equity because it is so often used with lenders wanting to loan individuals money based on their home equity. Home equity can be thought of as the amount of money an owner would receive if he/she sold their house and paid off any mortgage (loan) on the property.

Owner's equity (or net worth or capital) is increased by money or property contributed and any profits earned and decreased by owner withdrawals and losses.

All Balance Sheets contain the same categories of assets, liabilities, and owner's equity.

If you look below at our Balance Sheet for ABC Mowing you can readily see that there are three main sections, assets, liabilities, and owner's equity just like the accounting equation. The major sections of a balance sheet are the heading, the assets, the liabilities, and the owner's equity. The heading contains the name of the company, the title of the statement, and the date of the statement.

Navigation:
Interactive Links are provided in this Balance Sheet.

- Click on the Underlined **ABC Capital Amount** to see the amount transferred **from** the Capital Statement.
- Click on the Underlined Account Name (Item) in the Balance Sheet to see the amount in the Trial Balance that was used as an aid in preparing the Balance Sheet.

ABC Mowing			
Balance Sheet			
As Of December 31, xxxx			
Assets		**Liabilities**	
Cash	$5,080	Accounts Payable	2,060
Accounts Receivable	1,600	Notes Payable	10,000
Office Supplies	100		
Mowing Equipment	12,500	Total Liabilities	12,060
		Owner's Equity	
		ABC Capital	7,220
Total Assets	$19,280	Total Liabilities & Equity	$19,280

This layout is called the **account form**. In this form the major categories are presented side by side.

Another layout sometimes used is called the **report form**. In this form the major categories are stacked on top of each other. An example of the report form follows.

ABC Mowing

Balance Sheet		
As Of December 31, xxxx		
Assets		
Cash	$5,080	
Accounts Receivable	1,600	
Office Supplies	100	
Mowing Equipment	12,500	
Total Assets		$19,280
Liabilities		
Accounts Payable	$2,060	
Notes Payable-Bank	10,000	
Total Liabilities		$12,060
Owner's Equity		
ABC Capital		$7,220
Total Liabilities & Equity		$19,280

The Income Statement

The Income Statement is a formal financial statement that summarizes a company's operations (revenues and expenses) for a specific period of time usually a month or year.

A fiscal year is the period used for calculating annual (yearly) financial statements. While a large number of businesses use the calendar year (January-December) as their fiscal year, a business can elect to use any other twelve month period such as June-May as their fiscal year.

The categories and format(s) of the Income Statement also follow the rules known as Generally Accepted Accounting Principles (GAAP) and contains specific revenue and expense categories.

The following types of accounts are used to prepare the Income Statement.

Revenue (Also Called Income)
Formal Definition:The gross increase in owner's equity resulting from the operations and other activities of the business.

Informal Definition:Amounts a business earns by selling services and products. Amounts billed to customers

for services and/or products.

Expense (Also Called Cost)
Formal Definition:Decrease in owner's equity resulting from the cost of goods, fixed assets, and services and supplies consumed in the operations of a business.

Informal Definition:The costs of doing business. The stuff we used and had to pay for or charge to run our business.

Additional Explanation: Some examples of business expenses are office supplies, salaries & wages, advertising, building rental, and utilities.

Hopefully a business earns a profit called net income (revenues are larger than expenses). If however, expenses are larger than revenues a net loss results.

The major sections of an income statement are the heading, the revenue section, the expense section, and the final calculation of a profit or loss. The heading should contain the name of the company, the title of the statement, and the period covered by the statement.

An Income Statement is just a formal summary of "Mom Capital's "Kids" Revenue and Expense.

The Income Statement for ABC Mowing is presented below.

Navigation:
Interactive Links are provided in this Income Statement.
- Click On the Underlined **Net Income Amount** to see the amount transferred **to the Capital Statement** .
- Click on the Underlined Account Name (Item) in the Income Statement to see the amount in the Trial Balance that was used as an aid in preparing the Income Statement.

ABC Mowing		
Income Statement		
For The Period Ending December 31, xxxx		
Revenue from operations		$1,205
Expenses		
Advertising Expense	$225	
Mulch Expense	160	
Total Expenses		$385
Net Income		$820

Note: In the real world an income statement would have **many more** expense categories than the two types

illustrated in our **simple example**. Some additional expenses that would normally be included are:

- Office Supplies Used
- Telephone
- Building/Office Rent
- Utilities
- Depreciation Expense
- Maintenance and Repairs
- Interest Expense
- Memberships
- Donations
- Bank Fees and Charges
- Salaries & Wages
- Employment Taxes
- Equipment Rental
- Contract Labor
- Professional Fees
- Travel
- Entertainment
- **Any other type** that your business incurs

Our Income Statement or what is sometimes also referred to as a Profit and Loss Statement was prepared for a **service** type of business. Businesses that are retailers, wholesalers, or manufacturers that sell products have a **special section** included in their income statement called **Cost Of Goods Sold**. This section computes the Cost Of The Goods Sold that were either purchased and sold or manufactured and sold. In retailing and wholesaling, computing the cost of goods sold during the accounting period involves beginning and ending inventories. In manufacturing it involves finished-goods inventories, raw materials inventories and goods-in-process inventories.

The Capital Statement

The next financial statement, the capital statement, is prepared to report all the changes in owner's equity that occurred over a period of time usually a month or year. The major sections of the statement are the heading, the owner's capital balance at the beginning of the period, the increases and decreases during the period , and the calculated ending balance.

What do you think affects "Mom" (Owner's Equity) ? Of course her "kids" (revenue, expense, and draws) and any capital contributed to the business by the owner. We learned earlier that the activities of the "kids" revenue and expense are summarized in the Income Statement. This net income or loss is presented on a line in the Capital Statement. All the owner withdrawals (kid draws) is also presented on a line in the statement.

The capital statement serves as the bridge between the income statement and balance sheet. It uses the net income/loss from the income statement in addition to the owner's investments and withdrawal to determine the Owner's Capital balance shown on the balance sheet.

Let's illustrate this statement with a simple equation.
Ending Owner's Equity = Beginning Equity + Additional Capital Contributed + Profit or - Loss - Draws

Navigation:
Interactive Links are provided in this Capital Statement.

- Click on the Underlined **Ending Capital Amount** to see the the amount transferred **to** the Balance Sheet
- Click on the Underlined **Net Income Amount** to see the amount transferred **from** the Income Statement.
- Click on the Underlined Capital Beginning Description to see the amount that was transferred from the Trial Balance.
- Click on the Underlined Less Withdrawals to see the amount that was transferred from the Trial Balance.

ABC Mowing		
Capital Statement		
For The Period Ending December 31, xxxx		
Capital Beginning		$7500
Capital Contributed	0	
Net Income	820	
Less withdrawals	1,100	
Decrease in capital		280
Ending Capital		$7,220

How The Balance Sheet, Income Statement, and Capital Statement Are Related.

If you compare the owner's equity (owner's claim to assets) for two year end balance sheets, the difference (increase or decrease) is explained by the Income Statement and Capital Statement. Remember, revenues increase equity; capital contributed to the business increases equity; expenses decrease equity; and owner's draws decrease equity.

Statement Of Changes in Financial Position

The last financial statement, the statement of changes in financial position, is prepared to report all the changes in cash or working capital that occurred over a period of time usually a month or year.

The working capital form of the statement explains the increase or decrease in working capital for a period. **Note:**Working capital is the difference between current assets and current liabilities (Working Capital = Current Assets - Current Liabilities).

As you might expect, the cash form of the statement explains the increase or decrease in cash for a period. The statement is often called the Sources and Uses of Cash Statement when cash is used as the basis for

preparing the statement.

Since more and more of the accounting regulatory agencies are promoting using cash instead of working capital as the basis for preparing this statement, our example statement will also use cash.

The major sections of the statement are the heading, a section for reporting the increases in cash (resources provided by), a section for reporting the decreases in cash (resources applied to), and a summary of the change in cash (increase/decrease) for the period.

If the business was in operation in the previous year, the prior year balance sheet along with the current year balance sheet and current year income statement is needed in order to prepare the statement. Additional analysis of some of the accounts may also be needed.

Our example assumes that ABC Mowing's prior year balance sheet is as follows:

ABC Mowing		
Balance Sheet		
As Of December 31, xxxx (**Prior Year**)		
Assets		
Cash	$6,400	
Accounts Receivable	600	
Mowing Equipment	2,500	
Total Assets		$9,500
Liabilities		
Accounts Payable	$2,000	
Total Liabilities		$2,000
Owner's Equity		
ABC Capital		$7,500
Total Liabilities & Equity		$9,500

Using the above prior year balance sheet along with the current year balance sheet and income statement we prepared the following Statement Of Changes in Financial Position:

Summary of how to prepare the statement:

- The first step is determining the cash provided or used by operations and begins with the operating income for the period.
- Adjustments are made to the income for revenue or expenses items that did not provide or use cash.
- Additional adjustments are made for all current and noncurrent accounts and are recorded as addition or

subtractions depending upon their effect on cash based on their beginning of the year and end of the year balances.

ABC Mowing				
Statement Of Changes in Financial Position (**Cash**)				
As Of December 31, xxxx (**Current Year**)				
Sources of cash:				
Financing from bank loan			$10,0000	
Total sources				$10,000
Uses of cash:				
Income from operations	$820			
Add:				
Increase in accounts payable	60	$880		
Deduct:				
Increase in supplies inventory	100			
Increase in accounts receivable	1000	1,100		
Cash used by operations			220	
Payment of owner's draws			1,100	
Acquisition of equipment			10,000	
Total uses				11,320
Decrease in cash				$1,320
Change in cash balance:				
Cash balance, December 31, xxxx (Current Year)				$5,080
Cash balance, December 31, xxxx (Prior Year)				6,400
Decrease in cash				$1,320

Notes To The Financial Statements

Notes to the financial statements are an integral part of the statements and are required by Generally Accepted Accounting Principles. Notes to financial statements,sometimes referred to as footnotes, are used to provide additional information about a business's financial condition and methods used at arriving at the amounts presented in the financial statements.

These notes contain important information about such things as the accounting methods used for recording and reporting transactions, any pending lawsuits or regulations that may affect the business, and other information that should be disclosed in order to properly analyze and evaluate the financial condition of the business.

Where Do You Get The Information used to prepare these formal financial statements ?

A Trial Balance/Worksheet that we discussed in Lesson 5 is prepared from the General Ledger. The balances listed on this worksheet are listed in the order of the accounting equation. Asset balances are listed first; followed by Liabilities; and then Owner's Equity ("Ma Capital"); and finally her "kids" Revenues and Expenses.

Once you have a Trial Balance it's simply a matter of transferring the amounts from the Trial Balance to use to prepare the Balance Sheet, Income Statement, and Capital Financial Statements. Add in the prior year's balance sheet and you have the information needed for preparing the Statement of Changes in Financial Position (cash).

ABC Mowing's Trial Balance at the end of December

Navigation:
Interactive Links are provided in this Trial Balance.
- Click on the Underlined Account Name in the Trial Balance to be taken to the amounts transferred to the Balance Sheet, Income Statement, or Capital Statement.

Account	Debit Balances	Credit Balances	Account Type
Asset Accounts			
Cash	5080		Balance Sheet
Accounts Receivable	1600		Balance Sheet
Inventory-Office Supplies	100		Balance Sheet
Mowing Equipment	12500		Balance Sheet
Liability Accounts			
Accounts Payable		2060	Balance Sheet
Note Payable-Bank		10000	Balance Sheet
Equity Accounts			
Owner's Capital		7500	Balance Sheet
Owner's Draws	1100		Balance Sheet
Revenue Accounts			
Mowing Revenue		1205	Income Statement
Expense Accounts			

Mulch Expense	160		Income Statement
Advertising Expense	225		Income Statement
Totals	20765	20765	

It should be apparent that by having the information from the General Ledger and the Trial Balance one can readily prepare the Balance Sheet, Income Statement, and Capital financial statements.

The Trial Balance/Worksheet normally contains additional columns for adjusting and closing entries. Briefly, closing entries transfer (close) the balances in the General Ledger's individual revenue, expense, and drawing account(s) to the owner's capital account at the end of a period (usually year end) which results in the same General Ledger Capital Account ending balance as contained in the Capital Statement. This Ending Capital balance becomes the new Beginning Capital Balance for the new year. All the revenues, expense, and drawing account balances are reset to zero so that their balances will only represent transaction amounts (increases and decreases to owner's equity) in the new year.

Due to the fact that this is an introductory tutorial, adjusting and closing entry detail illustrations, discussions, and examples are reserved for a more advanced tutorial. Adjusting and Closing entries are discussed and illustrated in my **So, you want to learn Bookkeeping! - Special Journals Tutorial**.

The Good News

While these financial statements were prepared from just a very few transactions, my goal was to introduce you to what formal financial statements are needed and what's involved in preparing them even though the bookkeeper might not be required or responsible for preparing them. Many businesses have their accountant or CPA (Certified Public Accountant) prepare or review their financial statements. Even if the bookkeeper does not prepare them, they're still a key ingredient in properly analyzing and recording the transactions that are summarized in these statements.

Another plus, nowadays, good accounting or bookkeeping software will automatically generate these statements. While this is great, we still need to be aware of that ole saying "GIGO - Garbage In Garbage Out".

Are we there yet ?

Analyzing Financial Performance

While preparing financial statements is critical to the success of a business, it's only half the battle. In order for a business to fully benefit the financial information needs to be analyzed and compared. A few tools used are comparing past performance with current performance and comparing how the business stacks up against its competitors or similar businesses.

While the Financial Statements presented in this lesson are simplified versions of the "real" world and were compiled from only a few financial transactions, the concepts and methods used are the same as you would use for a business with a multitude of transactions.

So you know - things do change !

The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) are currently working on a joint project called the Financial Statement Presentation Project which, if the recommendations are adopted, will change the current formats of the Financial Statements. Basically, the financial information will be organized into groupings that will reflect the results of the operating, investing, and financing activities of a business.

Is this the last time under that darn light ? I'm not telling. You never know what lies in store for you in the final review lesson. See what you now about Financial Statements.

Financial Statements

Now's not the time for nail biting. You've made it this far and have only one lesson left in order to complete the course.

Yes, if you need one, you can take a break before moving on to the final lesson.

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Bean Counter							

So, you want to learn Bookkeeping!

by Bean Counter's Dave Marshall

Lesson 7

Review Of Major Concepts

Introduction	Lesson 1	Lesson 2	Lesson 3	Lesson 4	Lesson 5	Lesson 6	Lesson 7
Bean Counter							

Remember me ? Yeah, it's me Dave. It's not often that I get my picture in a publication twice but when you're the publisher you have a lot of leeway. I started out with you so I guess it's only fitting and proper that I also end with you.

Of course businesses have many more than the ten simple transactions that I used in my example of ABC Mowing. Probably 80% of a bookkeeper's time is spent recording and summarizing a business's financial transactions. I intentionally limited the transactions used in my prior lessons in order to focus on the broad concepts. My purpose (which I hope I accomplished) was to prepare you with a strong foundation that you can continue to build on.

What We Covered

Let's Review the path that got us here.

The **Introduction** discussed the types of business organizations, types of business activities, users of financial information, bookkeeping systems, accounting rules, and the cash and accrual basis of accounting.

Highlights:

Bookkeeping is the process of recording and classifying business financial transactions (activities). In simple language-maintaining the records of the financial activities of a business or an individual. Bookkeeping's objective is simply to record and summarize financial transactions into a usable form that provides financial information about a business or an individual.

Types Of Business Organization
One of the first decisions that a person(s) needs to make is how the company should be structured. The four basic legal forms of ownership for small businesses are a Sole Proprietorship, Partnership, Corporation, and Limited Liability Company. There are advantages and disadvantages as well as income tax ramifications associated with each type of organization. We aren't going to delve in to this area but a brief description of the different types of organization and what they are is needed.

Sole Proprietorship
Most small business start out as sole proprietorships. These firms are owned by one person who is normally active in running and managing the business.

Partnership
A partnership is two or more people who share the ownership of a single business. In order to avoid misunderstandings about how profits/losses are shared , who's responsible for what, and other management, ownership, and operating decisions the partners normally have a formal legal partnership agreement.

Corporation
A corporation is an organization that is made up of many owners who normally are not active in the decision making and operations of the business. These owners are called shareholders. Their ownership interest is represented by certificates of ownership (stock) issued by the corporation.

Limited Liability Company (LLC)

The LLC is a relatively new type of business structure that combines the benefits of a partnership and corporation.

Types Of Bookkeeping Systems

Single Entry
With the single-entry system, you record a daily and a monthly summary of business income, and a monthly summary of business expenses. Single-entry is not a complete accounting system, but it shows income and expenses in sufficient detail for tax purposes. This system focuses on the business' profit and loss statement and not on its balance sheet. The single entry system is an "informal" record keeping system. While the single entry system may be acceptable for tax purposes, it **does not provide** a business with all the financial information **needed to adequately report** the financial affairs of a business.

Double Entry System
The double-entry system has built-in checks and balances and is more accurate than single-entry system. The double-entry system is self-balancing. Since all business transactions consist of an exchange of one thing for another, double-entry bookkeeping is used to show this two-fold effect. This system is a **complete accounting system** and focuses on the income statement and balance sheet.

Cash Basis/Accrual Basis of Accounting
Another decision faced by a new business is what accounting/bookkeeping method they are going to use to track their revenue and expenses. If inventories are a major part of the business, the decision is made for the business owner by the Internal Revenue Service (IRS) and the business is required to use the accrual method of accounting.

The **Cash Basis** recognizes revenues (earnings) in the period the cash is received and expenses in the period when the cash payments are made. The **Accrual Basis** records income in the period earned and all expenses in the period incurred.

The following are some of the **Rules used to "play" the Accounting "Game"**:

- Accrual Concept
- Revenue Realization Concept
- Matching Concept
- Accounting Period Concept
- Money Measurement Concept
- Business Entity Concept
- Going Concern Concept
- Cost Concept
- Conservatism Concept
- Consistency Concept
- Comparable
- Materiality Concept
- Cost-Benefit Convention
- Industry Practices Convention

Lesson 1 The Bookkeeping Language introduced you to some of the terminology and definitions used in the accounting and bookkeeping language.

Highlights:

Major Type of Accounts:

Assets
Formal Definition:The properties used in the operation or investment activities of a business.

Informal Definition:All the good stuff a business has (anything with value). The goodies.

Additional Explanation: The good stuff includes tangible and intangible stuff. Tangible stuff you can physical see and touch such as vehicles, equipment and buildings. Intangible stuff is like pieces of paper (sales invoices) representing loans to your customers where they promise to pay you later for your services or product. Examples of assets that many individuals have are cars, houses, boats, furniture, TV's, and appliances. Some examples of business type assets are cash, accounts receivable, notes receivable, inventory, land, and equipment.

Liabilities
Formal Definition:Claims by creditors to the property (assets) of a business until they are paid.

Informal Definition:Other's claims to the business's good stuff. Amounts the business owes to others.

Additional Explanation: Usually one of a business's biggest liabilities (hopefully they are not past due) is to suppliers where a business has bought goods and services and charged them. This is similar to us going out and buying a TV and charging it on our credit card. Our credit card bill is a liability. Another good personal example is a home mortgage. Very few people actually own their own home. The bank has a claim against the home which is called a mortgage. This mortgage is another example of a personal liability. Some examples of business liabilities are accounts payable, notes payable, and mortgages payable.

Owner's Equity also called Owner's Capital
Comment: Both terms may be used interchangeably. In my tutorial lessons, I may refer to both terms or just use one or the other.

Formal Definition:The owner's rights to the property (assets) of the business; also called proprietorship and net worth.

Informal Definition:What the business owes the owner. The good stuff left for the owner assuming all liabilities (amounts owed) have been paid.

Additional Explanation:Owner's Equity (Capital) represents the owner's claim to the good stuff (assets). Most people are familiar with the term equity because it is so often used with lenders wanting to loan individuals money based on their home equity. Home equity can be thought of as the amount of money an owner would receive if he/she sold their house and paid off any mortgage (loan) on the property.

Revenue (Income), Expenses, Investment, and Draws
Revenues, expenses, investment, and draws are sub categories of owner's equity (capital). Think of owner's equity as a mom named Capital with four children to keep up with (I know she's only got one clinging to her leg but she left Expense, Investment, and Draws at home). The kids are named Revenue, Expense, Investment, and Draws and each kid has one job that they are responsible for in order to earn their allowance. **Kid Revenue** is responsible for keeping track of increases in owner's equity (Ma Capital) and **Kid Expense** is responsible for keeping track of decreases in owner's equity (Ma Capital) resulting from business operations. **Kid Draws** has the job of keeping up with decreases in owner's equity (Ma Capital) resulting from owner withdrawals for living expenses and other personal expenses. **Kid Investment** has the job of keeping up with increases in owner's equity (Ma Capital) resulting from additional amounts invested in the business.

Revenue also called Income
Formal Definition:The gross increase in owner's equity (capital) resulting from the operations and other

activities of the business.

Informal Definition:Amounts a business earns by selling services and products. Amounts billed to customers for services and/or products.

Additional Explanation:Individuals can best relate by thinking of revenue as their earnings/wages they receive from their job. Most business revenue results from selling their products and/or services.

Expense also called Cost
Formal Definition:Decrease in owner's equity (capital) resulting from the cost of goods, fixed assets, and services and supplies consumed in the operations of a business.

Informal Definition:The costs of doing business. The stuff we used and had to pay for or charge to run our business.

Additional Explanation:Some examples of personal expenses that most individuals are familiar with are utilities, phone, clothing, food, gasoline, and repairs. Some examples of business expenses are office supplies, salaries & wages, advertising, building rental, and utilities.

Owner's Investments
Formal Definition: Increase in owner's equity (capital) resulting from additional investments of cash and/or other property made by the owner.

Informal definition: Additional amounts, either cash or other property, that the owner puts in his business.

Additional Explanation:Although these amounts can be kept up with as a separate item, they are usually recorded directly in the Owner's Capital Account. In other words, immediately put into Ma Equity's purse.

Owner's Drawing
Formal Definition: Decrease in owner's equity (capital) resulting from withdrawals made by the owner.

Informal definition: Amounts the owner withdraws from his business for living and personal expenses.

Additional Explanation:The owner of a sole proprietorship does not normally receive a "formal" pay check from the business, but just like most of the rest of us needs money to pay for his house, car, utilities, and groceries. An owner's draw is used in order for the owner to receive money or other "goodies" from his business to take care of his personal bills.

Lesson 2 Property and Property Rights
explained Property & Property Rights, the Accounting Equation, double entry bookkeeping, and how business transactions affect the equation.

Highlights:

ACCOUNTING EQUATION.
Abbreviated version
PROPERTY=PROPERTY RIGHTS
or the expanded version
ASSETS=LIABILITIES + OWNER'S EQUITY
and lastly the fully expanded version (Lesson 3)
ASSETS = LIABILITIES + BEGINNING OWNER'S EQUITY + ADDITIONAL OWNER INVESTMENTS + REVENUE - EXPENSES - DRAWS

Remember Mom Equity and Her Kids and due to "Mom" Equity's other special responsibilities OWNER'S EQUITY expanded becomes

Current Owner's Equity (Capital) = Beginning Owner's Equity (Capital) + Owner's Investments + Revenues - Expenses - Draws

Owner Investments Increase Owner's Equity
Revenues Increase Owner's Equity
Expenses Decrease Owner's Equity
Owner's Draws Decrease Owner's Equity

Lesson 3 Debits and Credits introduced and explained Debits and Credits and how they affect the Accounting Equation and are used to record business transactions.

Highlights:

For Every Debit There Is A Credit

Debit- an entry (amount) entered on the left side (column) of a journal or general ledger account that increases an asset, draw or an expense or an entry that decreases a liability, owner's equity (capital) or revenue.

Credit - an entry (amount) entered on the right side (column) of a journal or general ledger account that increases a liability, owner's equity (capital) or revenue, or an entry that decreases an asset, draw, or an expense.

Debit and Credit Equation
Assets + **D**raws + **E**xpenses = **L**iabilities + **O**wner's Equity + **R**evenue
Normal Debit Balance Accounts = Normal Credit Balance Accounts

All You Need To Know About Debits and Credits Summarized In One Sentence:

Enter an amount in the **Normal Balance Side** of an Account to **Increase the Balance** of an Account and in the **Opposite Side** of an Account to **Decrease the Balance** of an Account.

How To Use and Apply The Debit and Credit Rules:
(1) Determine the type of account(s) the transactions affect-asset, liability, revenue, or expense account.
(2) Determine if the transaction increases or decreases the account's balance.
(3) Apply the debit and credit rules based on the type of account and whether the balance of the account will increase or decrease.

Good News
In the Introduction, I recommended that small as well as larger businesses use accounting and bookkeeping software. While the software for most transactions "automatically" handles the process of debiting and crediting the proper accounts, in some instances, you do have to record your own debits and credits such as when making adjusting entries. I also stated that you need a properly trained bookkeeper or accountant that is also familiar with the software product in order to properly use the software. Even recording the so called "automatic" transactions needs an educated person with **some bookkeeping knowledge and skills** to properly use the software.

Lesson 4 Recording Business Transactions explained and used examples to illustrate how business transactions are properly analyzed, recorded, and summarized.

Highlights:

Typical Types Of Business Transactions and Accounts Used To Record Them

In a typical business transaction we get something and we give up something.

- **Sale-Sell goods and/or services**
    - Cash Sale-customer pays at the time of sale
      The business **gets** cash or a check from their customer and **gives** up a product or service to their customer.
      Accounts Used:
      Debit: Cash
      Credit: Sales
    - On Account Sale-business allows the customer time to pay
      The business **gets** a promise to pay from their customer and **gives** up a product or service to their customer.
      Accounts Used:
      Debit: Accounts Receivable
      Credit: Sales
- **Purchase goods and/or services**
    - Cash Purchase-business pays the supplier at the time of purchase
      The business **gets** a product or service from their supplier and **gives** up cash or a check to

their supplier.
Accounts Used:
Debit: Expense or Inventory Account
Credit: Cash

  - On Account Purchase-supplier allows the business time to pay
    The business **gets** a product or service from a supplier and **gives** up a promise to pay to their supplier.
    Accounts Used:
    Debit: Expense or Inventory Account
    Credit: Accounts Payable

Pay Supplier Charge Purchases -pay suppliers for products and/or services that we promised to pay for later (charge).
The business **gets** the amount of their promise to pay the supplier reduced and **gives** up cash or a check.
Accounts Used:
Debit: Accounts Payable
Credit: Cash

- **Receive Customer Charge Payments** -receive payments from a customer that promised to pay us later (charge sale).
  The business **gets** cash or a check from their customer and **gives** up (reduces the amount of) their customer's promise to pay.
  Accounts Used:
  Debit: Cash
  Credit: Accounts Receivable
- **Borrow Money** (Loans) The business **gets** cash or equipment and **gives** up a promise to pay.
  Accounts Used:
  Debit: Cash or Equipment
  Credit: Note Payable
- **Repay a Loan**
  The business **gets** the amount of their promise to pay reduced and **gives** up cash or a check.
  Accounts Used:
  Debit: Note Payable
  Credit: Cash
- **Draw**
  The business **gets** the owner's claim to the business assets reduced and **gives** up cash or a check.
  Accounts Used:
  Debit: Owner's Draw
  Credit: Cash
- **Payroll** (not covered in this tutorial)
  The business **gets** services from their employees and **gives** up a check. **Accounts Used:**
  Debit: Salary & Wages Expense
  Credit: Cash

Lesson 5 The General Ledger and Journals explained what General Ledger and Journals are, how they're used, and what bookkeeping purposes they serve.

Highlights:

A **General Ledger** is just a book containing the summarized financial transactions and balances of the accounts for all of a business's assets, liabilities, equity, revenue, and expense accounts.

Journals are preliminary records where business transactions are first entered into the accounting system. The journal is commonly referred to as the book of original entry. Specialized Journals-are journals used to initially record special types of transactions such as sales, cash disbursements, and cash receipts in their own journal.

Lesson 6 Financial Statements explained what financial statements are, how they're created, and how they're used.

Highlights:

Financial Statements are summary accounting reports prepared periodically to inform the owner, creditors, and other interested parties as to the financial condition and operating results of the business. The four basic financial statements are:

Balance Sheet-The financial statement which shows the amount and nature of business assets, liabilities, and owner's equity as of a specific point in time. It is also known as a Statement Of Financial Position or a Statement Of Financial Condition.

Income Statement-The financial statement that summarizes revenues and expenses for a specific period of time, usually a month or a year. This statement is also called a Profit and Loss Statement or an Operating Statement.

Capital Statement-The financial report that summarizes all the changes in owner's equity that occurred during a specific period.

Statement of Changes in Financial Position-The financial statement that reports the sources and uses of cash or working capital for a specific period of time, normally a year.

Believe It Or Not
I know you probably got tired of ABC Mowing; but, using only our 10 sample transactions, we've covered the Basics Of Bookkeeping. Of course, in the real world, a business will have many more transactions that need to be analyzed and recorded; but, you apply the same methods and concepts that we learned and used in this Tutorial.

Darn It, back under that light again ! I didn't take this course to be tortured. You didn't think you were going to escape the last lesson without being tested did you ? See how you do with a few Quizzes.

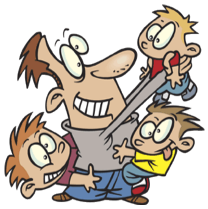
Basic Bookkeeping and Accounting Concepts - I

Basic Bookkeeping and Accounting Concepts - II

Basic Bookkeeping and Accounting Concepts - III

Debit/Credit Transaction Skills Test - Final

Additional Introductory Accounting and Bookkeeping Games and Quizzes



If you recall, in Lesson 6 I said that you never know what lies in store for you in the final lesson. Instead of being under the light, why not see what you know and have a little fun too !

- Bookkeeping and Accounting Games
  - **Fling The Teacher Game**
    The object of my Fling The Teacher Bookkeeping and Accounting Games is to build a trebuchet by correctly answering 15 questions. If you can get it completely built, you can get rid of me (at least for a little while) by using the catapult to fling me away. A trebuchet, for those like me that didn't know, is a catapult or type of medieval artillery used during sieges.
  - **Basketball**
    The object of my Basketball Bookkeeping and Accounting Games is to test your 3-point shooting skills in addition to testing your basic bookkeeping and accounting knowledge.
  - **Walk The Plank**
    The object of my Walk The Plank Bookkeeping and Accounting Games is to feed me to the sharks by making me walk the plank. You accomplish this by answering bookkeeping and accounting questions correctly.
  - **Teacher Invaders**
    This game is similar to one of my favorite games Space Invaders. The object of my Teacher Invaders Game is to score points by answering questions correctly and shooting the advancing teachers. You get time to shoot at the beginning of the game and additional time by answering bookkeeping and accounting questions correctly.
- Quick Quizzes
  Instead of clicking on the answer with your mouse, you just move your mouse over the answer you think is correct and you're immediately told whether your answer is right or wrong. When deemed necessary, you're also told why your answer was wrong.

Congratulations

My congratulations to all you Yogi Bears (Smarter Than The Average Bear) For those of you too young to remember, Yogi Bear is a cartoon character created by William Hanna and Joseph Barbara who always claimed to be smarter than the average bear. Hopefully, if I did my job, when it comes to bookkeeping, you can now claim to be smarter than the average bear. No I didn't say you're ready for the CPA exam yet !

Your Next Step

More Free Bookkeeping Courses !

My free So, you want to learn Bookkeeping! introductory bookkeeping course introduced you to basic bookkeeping and my style of presenting information. In addition to my Introductory Bookkeeping Tutorial, I've "cooked up" some additional courses (So, you want to learn Bookkeeping! Series Of Bookkeeping Tutorials) for those of you wanting or needing some additional bookkeeping and accounting education. If you've acquired a taste and have an appetite for more of my kind of cooking you need to check out these additional accounting tutorials.

So, you want to learn Bookkeeping! - Series

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Your Humble Tutor
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Bean Counter

Cartoons in this tutorial provided by Ron Leishman. If you enjoyed them, get some of your own Toon-A-Day.
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